

Confidential



# **Complaint Review and Mediation Scheme**

Reply of Post Office Limited to Second Sight's Briefing Report – Part Two

April 2015

---

This Reply is confidential. You may not disclose it to any other person except that Applicants to the Scheme may disclose it to those advising them on their complaint.

Confidential

**Contents**

Introduction .....	4
This Reply .....	6
Overview of Post Office's position .....	7
Post Office's response to section 1 – Introduction .....	11
Post Office's response to section 2 – Limitation of Scope in Work Performed .....	14
Post Office's response to section 3 – Risk Transfer .....	18
Post Office's response to section 4 – structure and content of the report.....	23
Post Office's response to section 5 – Scope and Definition of Horizon.....	24
Post Office's response to section 6 – The Contract between Post Office and Subpostmasters.....	25
Post Office's response to section 7 – Automated Teller Machines (ATMs).....	28
Post Office's response to section 8 – Motor Vehicle Licences.....	34
Post Office's response to section 9 – Foreign Currency Transactions.....	35
Post Office's response to section 10 – National Lottery .....	36
Post Office's response to section 11 – Training, Support and Supervision.....	40
Post Office's response to section 12 – The Helpline.....	44
Post Office's response to section 13 – Limitations in the Transactional "Audit Trail" .....	47
Post Office's response to section 14 – Transactions not entered by Subpostmaster or their Staff.....	51
Post Office's response to section 15 – Transaction Reversals.....	53
Post Office's response to section 16 – Cash and Stock Remittances (Rems) in and out of the branch.....	54
Post Office's response to section 17 – Missing Cheques .....	56
Post Office's response to section 18 – Pensions and Allowances .....	62
Post Office's response to section 19 – Surpluses.....	66
Post Office's response to section 20 – Counter-errors that benefit customers at the expense of the Subpostmaster .....	68
Post Office's response to section 21 – Error and fraud repellency and Horizon's 'fitness for purpose' .....	69
Post Office's response to section 22 – One-sided transactions.....	76

Confidential

Post Office's response to section 23 – Hardware issues .....	79
Post Office's response to section 24 – Post Office Audit Procedures .....	80
Post Office's response to section 25 – Post Office Investigations .....	81
Conclusion .....	83

Confidential

### Introduction

- (i) As part of the Complaint Review and Mediation Scheme (**the Scheme**), Second Sight was engaged as a firm of forensic accountants to provide a logical and fully evidenced opinion on the merits of each Applicant's case.
- (ii) On 21 August 2014, Second Sight's Briefing Report – Part Two (**the Report**) was sent as a confidential document to a number of Applicants and their advisors, as well as to Post Office. The purpose of the Report was to describe and expand on common issues identified by Second Sight as being raised by multiple Applicants (**a Reported Issue**), the aim being to provide general information that could then be applied in specific cases.
- (iii) Post Office was unable to endorse the first version of the Report. In the interests of transparency and with the overriding aim of assisting the resolution of complaints brought under the Scheme, Post Office prepared a Reply in order to correct inaccuracies in the first version of the Report and to provide information that that Report did not. That original Reply was dated 22 September 2014.
- (iv) In the first iteration of the Report, a number of Reported Issues were said by Second Sight to remain under investigation. Second Sight's investigations have continued since then and subsequently it issued to Post Office a final version of its Report on 9 April 2015.
- (v) Although Post Office has engaged directly with Second Sight to help analyse the Reported Issues and provided comprehensive information and explanations in relation to its processes, the Report still lacks clear and substantiated conclusions of general application which would assist the resolution of Applicants' complaints. In particular:
  - a. A number of the Reported Issues, which on first assessment appeared to demonstrate some general pattern or similarity do not reflect any systemic issue, but turn on the specific circumstances of the individual cases. They are therefore not matters that can be applied to Applicants generally but require a case by case assessment as has been done in the individual case reports of both Post Office and Second Sight.
  - b. The majority of the cases in the Scheme involve a loss of cash or stock in a branch for which an Applicant was held liable. Even where a Reported Issue of potentially general



Confidential

application has been identified by Second Sight, it has not been shown that that issue caused a loss of cash or stock.

- c. As explained in more detail below, the scope of the Scheme is to consider matters “*concerning Horizon and any associated issues*”. Matters such as the Subpostmaster contract and other legal matters are not within the scope of the Scheme and fall outside Second Sight’s professional expertise. Regrettably, Second Sight’s consideration of these topics has meant that the conclusions of the Report in these areas are therefore unreliable and often incorrect.
  - d. Throughout, the Report suffers from a lack of supporting evidence, source documents and/or examples or statistics to substantiate the conclusions it draws. Further, it does not describe the overarching methodology used to examine the weight of evidence from different sources – this is most important where the information provided by Applicants is anecdotal, unsupported by contemporaneous material.
- (vi) As a result, Post Office remains unable to endorse the final version of the Report and has therefore produced this updated Reply in order to correct the Report’s errors and provide additional, relevant information that the Report omits.

Confidential

### **This Reply**

- (vii) It is recommended that the reader familiarises themselves with Second Sight's Briefing Report – Part One (**the Part One Briefing**) which provides background information on Post Office's processes and procedures. This Reply builds on the information in the Part One Briefing.
- (viii) Care should be taken when seeking to apply the Report's findings and this Reply to individual cases since the extent to which they may or may not apply will very much depend on their specific circumstances.
- (ix) In this Reply:
  - 'Report' means the final version of the Report unless stated otherwise.
  - 'Reply' means this version of the Reply unless stated otherwise.
  - References to paragraphs and sections are to paragraphs and sections of the Report unless stated otherwise.
  - 'Applicant' means an applicant to the Scheme whereas 'Subpostmaster' means Subpostmasters in general, whether or not they have applied to the Scheme.
  - For ease of reference, where reference is made below to 'Subpostmasters' or 'Applicants' taking action in a branch, this action could, in most circumstances, also be taken by a Subpostmaster's assistant.
  - All other capitalised terms are defined in the Part One Briefing.

Confidential

### **Overview of Post Office's position**

- (x) Nearly all Applications to the Scheme centre on there being a loss of cash from a branch that the Applicant does not consider that they caused or for which they are liable. The purpose of this Reply is to help identify those issues that can cause such a loss and those that cannot.
- (xi) In order to identify a loss of physical cash, an investigator needs two pieces of key information:
  - a. How much cash should be in the branch as a result of the transactions processed in the branch. This information is provided by the branch accounts stored on Horizon.
  - b. How much cash is actually in the branch. This is known by conducting a physical count of the cash on hand.
- (xii) Any difference between the above two figures generates a 'discrepancy' which may either be a shortage or a surplus.

### **Controlling the branch accounts**

- (xiii) If cash is missing, the first stage of the investigation is to identify the day on which the cash went missing. The transactions for that day can then be reviewed for anomalies (see section 10 of the Part One Briefing) e.g.:
  - transactions incorrectly recorded (such as withdrawals being recorded as deposits); and
  - values incorrectly entered (e.g. entering £2000 instead of £200).
- (xiv) This is done to determine if the branch has made errors that would make the branch accounts inaccurate. This review must be done by the branch staff as only they will know the transactions performed on that day and may recall the correct transaction details. Many branch errors (including the two examples above) are most easily identified in branch. They would not be evident to Post Office unless, for instance, a complaint was made by a customer.
- (xv) Post Office helps correct branch errors where possible by reconciling Horizon records against data collected on some transactions by third parties such as banks and government departments. Where Post Office detects an error through this reconciliation process, it issues

Confidential

a Transaction Correction to a branch notifying them of the error and requiring an adjustment to the branch accounts.

- (xvi) It has been alleged by some Applicants that they have received Transaction Corrections even when they were not at fault. Transaction Corrections are only issued where there is clear evidence of an error in branch. Where the cause of loss rests with Post Office or a third party client, Post Office absorbs that cost and it is not passed back to the branch. This principle underpins the design of Horizon and all Post Office's back office and reconciliation processes.

### **Controlling cash movements**

- (xvii) Save when it conducts an audit, Post Office does not have any direct knowledge of what physical cash is actually in a branch – only Subpostmasters have this information. For this reason, branches are required to:
- count the amount of cash in the branch daily and record this figure on Horizon as a cash declaration; and
  - count all cash and stock at the end of each trading period and record these figures on Horizon before making good any discrepancies<sup>1</sup>.
- (xviii) If daily cash declarations are not made by a branch or declarations are made falsely (by declaring that there is more cash in the branch than there actually is) then it is impossible for Post Office, and will be very difficult if not impossible for a Subpostmaster to:
- know if cash is missing;
  - identify the day or days on which cash has gone missing;
  - identify which member of staff may be the source of errors; or
  - locate the erroneous transactions that caused a loss.
- (xix) Daily accurate cash declarations are the most critical aspect of branch accounting. Where these are not performed, losses of cash go unchecked.
- (xx) For this reason, it is critical that Subpostmasters make accurate daily cash declarations as a fundamental requirement of their contract with Post Office. Subpostmasters habitually failing

---

<sup>1</sup> See paragraph 8.8 of the Part One Briefing regarding "making good" errors.

Confidential

to make cash declarations may find their contracts terminated. Post Office also prosecutes those Subpostmasters who dishonestly make false cash declarations. It is not an excuse to say that a Subpostmaster was poorly trained or received inadequate support in this regard. The need for daily cash declarations is known by all Subpostmasters and is easily done – there is no specialist training or support required. Post Office does not accept that there are any circumstances capable of justifying committing the criminal offence of rendering a false account.

- (xxi) In the context of the Scheme, there are a number of cases where accurate cash declarations have not been made. Many of these Applicants have challenged Post Office to identify the cause of losses in their branches which they had hidden by falsely accounting. As explained above, identifying the specific source of the losses is not possible where an Applicant has failed to follow the simple but critical task of making accurate daily cash declarations.
- (xxii) Subpostmasters are contractually liable for any losses hidden or caused by their inaccurate record keeping whether owing to error, dishonesty or otherwise. It is also a well-established common law principle that an agent (e.g. a Subpostmaster) is liable to account to his principal (e.g. Post Office) for any sum declared in his accounts.

### **Responsibility for losses**

- (xxiii) A number of Applicants have accused Horizon of inaccurately recording the transactions processed at their branch which, they say, shows that they were not liable for the losses in their branches. To date, Post Office has not been provided with any evidence, either by an Applicant or in the Report, of Horizon's failure to record transactions accurately.
- (xxiv) The Report looks to identify points where Second Sight considers that Horizon may be flawed. However, these points are either not supported by evidence or have been proved not to be the cause of losses in branches.
- (xxv) Absent any doubt over the integrity of the branch accounts produced by Horizon, Post Office considers it fair to assume that if a loss has occurred then it has been caused in the branch and is something for which, in most circumstances, a Subpostmaster is liable to make good.

Confidential

This reflects the core tenet of the Subpostmaster Contract that Subpostmasters are liable for any loss caused by their carelessness, negligence, dishonest conduct or error<sup>2</sup>.

(xxvi) Post Office has investigated every allegation made about Horizon through the Scheme. It is in its interest, as well as the interest of the 8,000 serving Subpostmasters who have not applied to the Scheme, to identify an issue if one exists. However, there is no evidence of systemic problems with branch accounting on Horizon. All existing evidence overwhelmingly supports this position.

---

<sup>2</sup> See paragraph 8.8 of the Part One Briefing regarding "making good" errors.

Confidential

**Post Office's response to section 1 – Introduction**

- 1.1 Section 1 of the Report provides details around Second Sight's initial investigation and the establishment of the Complaint Review and Mediation Scheme. This section does not explain that Second Sight has performed two distinct roles in two discrete phases.
- 1.2 In early 2012, a group of Members of Parliament led by the Rt Hon James Arbuthnot MP raised a number of concerns with Post Office over the reliability of Horizon, having been approached by a small number of mainly former Subpostmasters under the banner of the Justice for Subpostmasters Alliance (**JFSA**). These Subpostmasters considered that apparently unexplained accounting issues in their Post Office branches might be the product of a flaw in the Horizon operating system.
- 1.3 Given the serious nature of the issues raised, Post Office agreed to appoint an independent firm of forensic accountants (**Second Sight**) to investigate these claims as a matter of urgency. The basis of Second Sight's initial engagement was reflected in a document for Subpostmasters entitled 'Raising Concerns with Horizon', and included the requirement to:
- "Consider and advise on whether there were any systemic issues and/or concerns with the Horizon system including training and support processes, giving evidence and reasons for the conclusions reached."*
- This scope of work expressly did not extend to investigating or commenting on any individual concerns raised.
- 1.4 After a year's investigation, Second Sight issued an 'Interim Report' dated 8 July 2013 which stated that they had found:
- "no evidence of system-wide (systemic) problems with the Horizon software".*
- 1.5 However, Second Sight considered that a limited number of other issues may have contributed to difficulties being experienced by those Subpostmasters who had raised concerns, most notably around the effectiveness of the support offered to them by Post Office in their individual cases. The Interim Report did not, as claimed at paragraph 1.8 of the Report, conclude that Second Sight needed to look at the "*totality of the user experience of Horizon*". Nor did it conclude as also claimed at paragraph 1.8 that "*many of the concerns*

Confidential

*reported to [Second Sight] clearly demonstrated problems with the interface between Horizon and other systems".* Neither statement is reflected in the Interim Report.

- 1.6 Since Second Sight had not found any evidence of systemic issues with Horizon that could affect all Subpostmasters, Post Office decided to establish the Scheme in order to provide an avenue for Subpostmasters to raise their specific concerns regarding "*Horizon and associated issues*" directly with Post Office on an individual, case by case, basis.
- 1.7 The purpose of Second Sight's engagement by Post Office changed fundamentally following the establishment of the Scheme. Whereas Second Sight had previously been concerned with reporting to Post Office about the workings of Horizon as a system (and not individual concerns), its remit was now to focus on the individual complaints about Horizon in the Scheme. In doing so, they were to investigate, as forensic accountants, the specific issues raised by each Applicant concerning Horizon or associated issues, and report on these to Post Office and the Applicant. The Scheme was not, as alleged in paragraph 1.7, an extension of the original inquiry that led to the Interim Report.
- 1.8 The alleged "*undertakings*" from Post Office regarding access to information and scope of work, referred to in paragraph 1.3 of the Report, appear to relate to Second Sight's initial investigation, which was a general review of Horizon which concluded when Second Sight issued its Interim Report in July 2013. Accordingly, they would not be applicable to the Scheme, being a review of specific issues about Horizon raised by, and particular to, individual Applicants.
- 1.9 Those "*undertakings*" also do not reflect the '*Raising Concerns with Horizon*' document nor the Scheme documentation, both of which have been publicly disclosed, and both of which clearly define the two different stages and different purposes of Second Sight's work. Both documents however, expressly state that Second Sight's work was to be confined to the Horizon system and the training and support processes / associated issues connected with it.
- 1.10 In line with the above, Second Sight's work is now, having reviewed 116 of the 136 cases accepted into the Scheme and having produced its final version of the Report, almost complete.
- 1.11 Although Post Office has given Second Sight notice to end its engagement, Second Sight will first complete its investigation into the remaining cases. No supplemental report will



Confidential

therefore be needed from Second Sight (as suggested in paragraph 1.14 of the Report) as any residual issues can be addressed in Second Sight's individual case reviews.

Confidential

### **Post Office's response to section 2 – Limitation of Scope in Work Performed**

- 2.1 Before and during the Scheme, Post Office has provided Second Sight with a considerable amount of information including:
- a. Spot Reviews;
  - b. Post Office's comprehensive investigation findings into specific cases;
  - c. line-by-line comments on Second Sight's own case reports;
  - d. technical papers on particular issues raised by Second Sight;
  - e. detailed feedback on Second Sight's first version of the Report and feedback on a draft version of the final Report; and
  - f. answers to more than 100 questions posed by Second Sight.
- 2.2 Section 2 of the Report, however, suggests that Post Office has not made available all of the information it has previously committed to providing. This suggestion, which relates to the three broad areas covered in the following paragraphs, is incorrect.

### **Access to the complete legal files**

- 2.3 Second Sight says that it needs access to Post Office legal files because Applicants have raised concerns about Post Office's "*investigative and prosecution processes*". These matters do not fall within the terms of Second Sight's engagement. The Report incorrectly suggests (at paragraph 2.7) that the Working Group sanctioned Second Sight to analyse prosecutions conducted by Post Office. No such instruction was ever given by the Working Group.
- 2.4 Nevertheless, Post Office has provided non-legally privileged material from its relevant 'legal' files so that Second Sight can see the bundle of documents which would have been made available to the defence lawyers and the Courts. This would include documents such as witness statements and exhibits – in short, anything which Post Office relied on to support a criminal charge or which could undermine the prosecution or support the defendant's case. In addition, Post Office agreed to provide, where held, other Court documents such as a memorandum of conviction.

Confidential

- 2.5 At paragraph 2.5 the Report questions whether there have been any miscarriages of justice. Post Office takes any allegation of this nature extremely seriously. In none of Post Office's own investigations, nor through all of Second Sight's work, has any evidence emerged to suggest that a conviction is unsafe. Nevertheless, Post Office will engage with the appropriate independent bodies to review any possible miscarriage of justice (noting that matters relating to criminal law and procedure, such as prosecutor conduct and the safety of convictions, are outside Second Sight's scope of expertise as forensic accountants).

#### **Access to the emails of Post Office employees working at Bracknell**

- 2.6 In 2013, Second Sight asked for the email accounts of a number of Post Office employees dating from 2008. This was in response to an issue raised by Second Sight as part of its initial investigation, prior to the publication of its Report in July 2013. The allegation related to whether the Horizon test environment in the basement of Fujitsu's office in Bracknell could have been used to edit live branch data. Post Office explained at the time that it may be difficult to provide such information in view of its age but did, in May 2013, provide the email data it was then able to retrieve.
- 2.7 In order to address the allegation more comprehensively, Post Office also provided Second Sight with a witness statement from a key member of staff who worked at a Fujitsu site at Bracknell. This confirmed that the basement was a secure test environment, there was no connection to any live transaction data; live transaction data could not be accessed from the basement; and the basement was never used to access, change or manipulate live transaction data in branches. In addition, Post Office provided Second Sight with a considerable amount of policy documentation relating to the Bracknell office covering systems access, building access and security. Recently, in relation to a further request, Post Office provided Second Sight with emails from key staff during August 2008; this being the month in which the key events which triggered for this line of enquiry were said to take place.
- 2.8 The Report links the questions around the test environment in Bracknell to the possibility of some form of unauthorised remote access to transaction data. Post Office notes that no evidence of unexplained alterations of transaction data has been provided. To be clear, Horizon does not have functionality that allows Post Office or Fujitsu to edit or delete the transactions as recorded by branches.

Confidential

### **Transaction data relating to third party client accounts**

- 2.9 In June 2014, Second Sight asked Post Office to explain the operation of its Suspense Account. Post Office replied to that request in a written paper in July 2014. Second Sight then made a request for further data on the accounting entries being posted to the Suspense Account. Given that the purpose of this request was unclear, Second Sight agreed to provide further clarity on the nature of the enquiry, which it did in October 2014. Following some residual uncertainty over the focus and purpose of the request, Post Office sent a further written paper to Second Sight explaining the operation of its Suspense Account.
- 2.10 Whilst Post Office acknowledges it originally took longer to respond to Second Sight's initial requests than it would have wished, it was able to answer Second Sight's questions when a shared understanding of the nature of the enquiry had been reached.
- 2.11 Post Office's Chief Financial Officer has held two meetings with Second Sight to discuss these matters and has provided Second Sight with further 'contextual data'. At the most recent meeting, Second Sight agreed that it needed no further information on the Suspense Account and Post Office has provided examples to reassure Second Sight that unmatched differences were not left for long periods in the underlying client accounts, thereby masking issues.
- 2.12 It is also not the case, as stated in the Report, that, for most of the past five years, substantial credits have been made to Post Office's Profit and Loss Account as a result of unreconciled balances held by Post Office in its Suspense Account. Post Office compares its data with that of third parties in the normal way and the credits are not at all substantial in that context.
- 2.13 Similarly, the statements at paragraphs 2.18 and 2.19 about Post Office client accounts are equally inaccurate. Second Sight appears to have misunderstood the information provided by Post Office. The balances of £96m and £66m were taken from routine trading balances yet to be settled with other organisations at a particular month end. In other words, they represent amounts due to other parties, not amounts that are unreconciled and which may be due to Subpostmasters. As previously reported to Second Sight, the fact that gives genuine comfort is that neither account had any unreconciled balances which were more than six months old. If the client accounts were being operated as an alternative suspense account (as can be inferred from the Report) this would not be the case.

Confidential

- 2.14 Taking this with the work previously shared on the suspense account, Post Office can see no grounds for any ongoing concern.

Confidential

### Post Office's response to section 3 – Risk Transfer

- 3.1 Section 3 of the Report broadly pulls together a number of strands elsewhere in the Report into an allegation that Post Office had improperly transferred 'risk' to Subpostmasters over time. Once the constituent elements of this claim are properly analysed, it becomes clear that either they are unsupported by evidence, or the underlying analysis is incorrect.
- 3.2 Second Sight premises this view on three limbs:
- a. the Subpostmaster Contract;
  - b. changes in processes that make operating a branch more difficult for Subpostmasters; and
  - c. the error-repellency of Horizon.

#### The Subpostmaster Contract

- 3.3 Detailed comments on the Subpostmaster Contract are set out in section 7 of this Reply. However, at paragraph 3.6 of the Report it is suggested that the Contract does not commit Post Office to support Subpostmasters in finding the source of losses in their branches.
- 3.4 First, under the terms of the Contract, Subpostmasters are only responsible for losses caused through their "*own negligence, carelessness or error*" or for losses caused by their assistants. Subpostmasters are therefore only liable for losses arising from those operations that are under their control and responsibility. As described in the overview above, Subpostmasters play a critical role in identifying the cause of losses and often Post Office, which is not in attendance in any branch, cannot know what has happened.
- 3.5 Second, and contrary to the suggestion in paragraph 3.7 of the Report, support is available to Subpostmasters from the Post Office Helpline in relation to dealing with discrepancies. Further support is also available from the Post Office's Finance Service Centre (**FSC**), the Branch Support Team and the Field Based Training Team.
- 3.6 FSC could become aware of issues owing to:
- a branch calling FSC directly or being referred to FSC via the Helpline;
  - FSC identifying an anomaly in a branch from its accounting records; or

Confidential

- a customer raising an enquiry to the Post Office about a transaction in a branch.
- 3.7 FSC works with a branch to try to identify the cause of any erroneous transaction. This may include speaking to the branch about how they have conducted the transaction, asking the branch to provide missing details, checking the paper records held at the branch against the transaction data on Horizon, liaising with clients (whether customer banks, utility companies, etc.) to gather different data streams on a transaction, and contacting customers to obtain their consent to remedy errors.
- 3.8 The Branch Support Team and the Field Based Training Team assist branches when NBSC and/or FSC are unable to resolve the query or issue by way of a telephone discussion and on-site (in branch) support is required.

#### Changes in operating practices

- 3.9 The second limb of Second Sight's argument is that Post Office has changed its practice in ways that make it more difficult for Subpostmasters to operate.
- 3.10 It should be noted that the Subpostmaster Contract provides that Post Office may only require Subpostmasters to offer new products and services where it is "*reasonable*" to do so. The contention that the Subpostmaster Contract provides Post Office with a carte blanche to dictate to Subpostmasters is wrong.
- 3.11 In paragraph 3.10, the Report sets out five examples of changes to business processes that Post Office allegedly implemented without proper consultation and which transferred additional risk to Subpostmasters. In none of these examples has Second Sight properly explained how they result in a transfer of risk to Subpostmasters:
- a. **Phasing out of Third Party ATMs** – Although this led to Subpostmasters taking on responsibility for operating ATMs, their remuneration was accordingly increased to reward this extra responsibility. Also, a Subpostmaster can refuse to operate an ATM in their branch if they do not want to take on this responsibility.
  - b. **Removal of paper paying in slips**. As explained in more detail in Section 14, this change was initiated by the UK banking industry which, over the last 5-10 years, has removed paper paying in slips in place of customers making banking deposits using a

Confidential

chip and pin card. The chip and pin system is more secure and less prone to error and, if anything, has de-risked this process for Subpostmasters.

c. **Introduction of new products such as Lottery products and Foreign Currency services.**

No explanation is provided in the Report as to how these changes have transferred risk to Subpostmasters.

d. **Removal of Suspense Accounts.** This function was not removed but changed into the Settle Centrally and Dispute function described at paragraph 9.5 of the Part One Report. This allegation is therefore incorrect.

e. **Change from weekly to monthly balancing.** No explanation has been provided as to how this change transferred risk to Subpostmasters, particularly given that it is, and always has been, open to Subpostmasters to balance their accounts on a weekly basis (or at any other time). The move to monthly balancing simply meant that the only compulsory balance that needed to be undertaken was at the end of the trading month.

3.12 These five examples therefore provide no support for the Report's conclusion in this section about risk transfer.

### The error repellency of Post Office's business systems

3.13 The suggestion made at paragraph 3.11 that "*there is little incentive for Post Office to improve the error repellency of its business systems*" is incorrect. As recognised by Second Sight at paragraph 3.12, human error has been found to be the primary cause of cash and stock losses in the cases investigated. Such errors are not only detrimental to Subpostmasters but also to Post Office. For this reason, and the reasons described in more detail in section 22, Post Office does regularly improve its systems.

3.14 In paragraph 3.13, the Report sets out 7 examples of alleged inadequacy in Horizon's error repellency:

a. **Hardware and technology failure rate.** The Report does not establish that hardware failures cause errors in branch accounts. Indeed at paragraph 23.4, in the section on Hardware Issues, the Report states that Second Sight "*have been unable to come to a reliable, evidence based view on this matter*".



Confidential

- b. **Telecommunications equipment.** The telecommunications line to a branch is, in large part, provided by the Subpostmaster. This is not part of the Horizon system.
- c. **Limited testing of Horizon.** Second Sight has undertaken no analysis of the user experience testing undertaken by Post Office and therefore has no evidence on which to form the view that this testing was “*limited*”.
- d. **No auto-calibration of the touch screen icons on the Horizon screen.** Although the screen does not ‘auto-calibrate’ there is a screen calibration application which can be invoked at any time by the Subpostmaster from the Engineering menu of Horizon. If the screen is out of calibration then that would affect the whole screen and not individual icons so it would be obvious to the user that the screen had gone out of alignment. If this issue is noticed and a call made to the Helpdesk then the Subpostmaster or staff member would be asked by the agent to re-calibrate their screen to fix the issue.
- e. **Lack of token-based access to Horizon.** Horizon uses unique user passwords to control access to the system. If a user shares their user ID and password with another person, this cannot be prevented by software as there would be nothing to suggest to the system that anything untoward was occurring. Using a token-based access system is open to the same possibility of misuse as users could share tokens. User ID and password sharing is a serious contravention of procedure. Only a Subpostmaster is in a position to stop this happening.
- f. **No software to detect suspicious out of hours transactions.** Subpostmaster can check for this as they have access to the dates and times of the transactions conducted in their branches. In those cases where Applicants identified specific transactions that they did not recognise this was shown to have been caused by a number of innocent reasons (e.g. the Applicant forgot that they had done the transactions, the transaction was done by another member of staff without the Applicant’s knowledge, etc.)
- g. **Lack of additional controls over high value transactions.** The Report does not explain what these controls may be. It is noted that this would typically mean some sort of escalation process to a higher grade member of staff for authority. However, Post Office has no control over the management structure offered in branch; this is a Subpostmaster’s responsibility and so is the implementation of such controls.

Confidential

## **Conclusion**

- 3.15 As can be seen from the above paragraphs, none of the three limbs of the Report's arguments in this Section can be substantiated. Second Sight has not therefore demonstrated any unfair transfer of risk to Subpostmasters. Where errors occur in branch, a Subpostmaster is responsible for these as they are within their control.

Confidential

**Post Office's response to section 4 – structure and content of the report**

- 4.1 Section 4 of the Report focuses on Second Sight's approach to the Report and correctly puts the 150 applications to the Scheme into the context of a network of over 11,500 branches and almost 500,000 users of the Horizon system since its introduction.
- 4.2 Post Office notes that in paragraph 4.7 the Report comments on the "*impact*" on "*most of the Applicants*", although Second Sight has not made any assessment of that impact by reference to any methodology, evidence and/or analysis. In those circumstances, it is difficult to see how the Report reaches this view. Further, this paragraph assumes that all Applicants have suffered problems with Horizon – for the reasons set out generally in this Reply, this is not correct.
- 4.3 Further, paragraph 4.10 implies Post Office did not, until recently and where possible, preserve documents related to cases in the Scheme which would otherwise be destroyed under Post Office's data retention period. Although some cases are very old and fall outside the standard retention periods for keeping information, Post Office has gone to considerable lengths to search its records and provide as much evidence as possible. Thousands of pages of information have been identified, recovered and made available both to Applicants and Second Sight.

Confidential

### **Post Office's response to section 5 – Scope and Definition of Horizon**

- 5.1 The Section of the Report defines the Horizon system. Post Office agrees that this definition reflects the scope of the Scheme (as described in section 1 above) which is to consider matters “*concerning Horizon and any associated issues*”.
- 5.2 As explained above, matters such as the Subpostmaster contract and other legal matters are not within the scope of the Scheme and are outside Second Sight's professional expertise.

Confidential

### **Post Office's response to section 6 - The Contract between Post Office and Subpostmasters**

- 6.1 Section 6 of the Report concerns the contract between Post Office and Subpostmasters dated September 1994 (as revised over the years) (**the Contract**). It considers (1) the potential impact of some of the terms and conditions and (2) issues relating to notification of the Contract terms to Subpostmasters.
- 6.2 An assessment of the Contract is outside the scope of the Scheme which was to consider "*Horizon and associated issues*". Second Sight has no mandate to consider the Contract and the Report contains a number of statements that are incorrect. Neither the Second Sight Directors, nor, to the best of Post Office's knowledge, any of the people engaged by Second Sight to undertake work in relation to the Scheme, have either qualifications or expertise to comment on issues such as the Contract which can only be undertaken against legal principles. For this reason, no weight should be placed on this section of the Report as it reflects only Second Sight's lay opinion.
- 6.3 To help avoid potential confusion, Post Office sets out the correct position in respect of the Contract below.

### **Fairness of the Contract**

- 6.4 Paragraph 6.7 concludes that "*from a business perspective*" the contractual provisions referred to above (in particular Section 12 requiring the Subpostmaster to make good losses) operate to the detriment of, and are unfair to, a Subpostmaster.
- 6.5 The Contract is a business to business arrangement. Save in a few very narrowly defined areas (which are not applicable here), there is no general principle at law of whether the Contract is 'fair' or not. In Post Office's experience, the terms of the Contract are broadly similar to those used in franchising arrangements across the UK.
- 6.6 In any event, Subpostmasters are agents and Post Office is their principal. At law, agents owe duties to their principals including the duty to act in good faith, to render accurate accounts and to make good any losses they cause. Section 12 of the Contract simply reflects these legal principles.

Confidential

- 6.7 The Contract reflects the basis on which Post Office and thousands of Subpostmasters have successfully conducted business for decades and it is neither commercially nor legally unfair.

#### **Subpostmasters' understanding of the Contract**

- 6.8 The Report suggests that Subpostmasters may not have reviewed or fully understood the terms of the Contract before entering into it. As a result, the Report states, at paragraph 6.11, that Subpostmasters are unable to mitigate "*risks*" that they may face. Post Office disagrees with this conclusion. In addition, this conclusion is not supported by any evidence.
- 6.9 The Contract that is entered into between Post Office and Subpostmasters is done so freely and at arm's length. Ultimately, it is for the Subpostmasters to choose whether they enter into the Contract or not.
- 6.10 The Report provides no evidence that Subpostmasters do not understand the Contract. If the view being taken in the Report is from a "*business perspective*" (whether Post Office or a Subpostmaster) the provisions are very clear and written in plain English.
- 6.11 In any event, it is a well-established legal principle that a person who agrees to a contract is bound by its terms even if he does not have a copy of those terms, has not read them or does not understand them. Post Office cannot be responsible for a Subpostmaster who may not have taken the time to read the Contract.
- 6.12 The Report also notes that Post Office does not recommend that Subpostmasters take legal advice. There is no obligation on Post Office to make this recommendation. It is however open to any Subpostmaster to take legal advice on the Contract at any time. The reference to the BFA standards at paragraph 6.10 is not applicable. The BFA recommendation is directed to franchisees (in a similar position to Subpostmasters). The BFA does not recommend that franchisors (in a similar position to Post Office) insist that legal advice be taken by franchisees. If anything, the BFA's advice supports Post Office view that responsibility lies with the Subpostmaster to understand their contract terms and Subpostmasters are free to seek and obtain advice if they so wish.

#### **Notification to Subpostmasters of the Contract terms**

- 6.13 Paragraphs 6.12 to 6.16 state that Post Office does not provide a copy of the Contract to Subpostmasters. This appears to be based on the fact that a Subpostmaster does not recall

Confidential

receiving the Contract or cannot now produce a copy. This does not mean that the Contract was not provided. Given the age of some of the cases in the Scheme (some going back over 10 years), it is not surprising that recollections are hazy and that some records are now not available.

- 6.14 It is open to Subpostmasters to request a copy of the Contract throughout negotiations when seeking appointment and from Post Office's Human Resource Service Centre if they have misplaced or lost a copy. It is also Post Office's standard operating procedure to ensure that the Subpostmasters have a full copy of the Contract no later than the day that they commence their position.
- 6.15 Paragraph 6.14 highlights that it is common practice for new Subpostmasters to sign an 'Acknowledgement of Appointment' without a copy of the Contract. It is common practice that a separate document will be signed rather than the full Contract. As a point of law, terms and conditions can be incorporated into a contract by reference to another document that is not signed. This is therefore a valid method of creating a legal relationship binding on Subpostmasters.

Confidential

**Post Office's response to section 7 – Automated Teller Machines (ATMs)**

- 7.1 Section 7 of the Report raises various issues concerning the accounting in branch for ATM transactions.
- 7.2 The Report does not clarify which precise part of the ATM accounting process is under consideration by Second Sight. In broad terms, the accounting process breaks down into three elements:
- a. loading – cash for the ATM is sent to the branch by Post Office and is loaded by the Subpostmaster into the ATM. This requires the recording of the ATM cash as part of the branch's stock.
  - b. cash dispensed – the amount of cash dispensed by an ATM is recorded daily on Horizon – see further below; and
  - c. exceptions – rejected cash and retracted cash – see further below.
- 7.3 From the content of the Report, Post Office believes that Second Sight has focused primarily on the processes for the recording of cash dispensed from the ATM, however other issues are also touched on. Second Sight mischaracterises some of these processes (which have been highlighted to Second Sight by Post Office previously) meaning this section of the Report lacks a coherent evidence base for its claims.
- 7.4 In short, nothing in this section of the Report gives rise to any issue that could cause a loss of cash in a branch. The Report does highlight a few areas where Applicants have claimed to struggle with accounting for ATM transactions, but the design of the accounting process and the safeguards put in place by Post Office mean that even a failure to account for ATM transactions will, save in a few minor areas (highlighted below), not cause a loss to a branch.

**Out of sync / Air Gap**

- 7.5 The Report focuses on the situation where cash is dispensed from an ATM. The process for accounting for dispensed cash is set out at paragraph 5.27 of the Part One Briefing. In short, on a daily basis (or on a Monday following a weekend) the Subpostmaster prints a receipt



Confidential

- from the ATM showing the amount of cash dispensed. This cash dispensed figure is then entered into Horizon by the Subpostmaster.
- 7.6 Simultaneously, the amount of cash dispensed is also automatically transmitted to Bank of Ireland (**BOI**) by the ATM. This means that there are two parallel records kept of the cash being dispensed by the ATM: one by the Subpostmaster on Horizon and one by BOI.
- 7.7 The Report notes that there are situations when these two systems can become 'out of sync' with one another, with one record showing more or less dispensed cash than the other record. This could be caused by the Subpostmaster entering the wrong figure on Horizon.
- 7.8 What is not highlighted by the Report is that even if the amount of money dispensed by an ATM as recorded on Horizon by the Subpostmaster is different from the amount actually dispensed as recorded by BOI, therefore resulting in the records being 'out of sync', this does not result in there being a loss to the branch. This is a pure accounting error by the branch.
- 7.9 There is a subsequent reconciliation of the Horizon figure against the BOI accounts. This means that any error on the Horizon account as to the amount of cash dispensed by the ATM would be picked up within a matter of days and corrected by way of a Transaction Correction to the branch. The Report acknowledges this at paragraph 7.8.
- 7.10 As a result of this process, there is no difference in the amount of cash held on site. Indeed, these accounting processes do not require anything to be done with the physical cash at all. Simply because the accounts may be 'out of sync' for a short period does not mean that there is a loss suffered by the branch. In summary, the Air Gap / out of sync issue cannot be a cause of loss in branch.

#### **Complexity of the 'cash dispensed' accounting process**

- 7.11 At various points, the Report suggests that Applicants found it difficult to account for cash being dispensed from ATMs (see paragraph 7.21).
- 7.12 As described above, the ATM automatically records the amount of cash dispensed. The only part of the process that is manual is the need for the Subpostmaster to take the cash dispensed figure from the ATM and enter it into Horizon. Second Sight has adopted the phrase 'Air Gap' for this manual interaction.

Confidential

- 7.13 Within this accounting process, no calculation or counting is required – it is literally typing a single figure into Horizon on a daily basis. Post Office does not accept that this process is too complicated to follow and that any failure to follow the process is down to the Subpostmaster or their staff.
- 7.14 In any event, as described above, any mistake in following this process will not cause a loss.

### **ATM Support**

- 7.15 The Report notes that Applicants have alleged that the Helpline repeatedly told them that in respect of the 'out of sync' error the "*problem would sort itself out*".
- 7.16 The advice provided by the Helpline needs to be assessed on a case by case basis as there is no evidence that there is a general issue with the advice provided. Even if the advice provided was that an error would "*sort itself out*", in light of the reconciliation between Horizon and BOI (as described above) any 'out of sync' problem would be corrected by a Transaction Correction. This would prevent the build-up of any accounting shortfalls. As explained above, there is no loss caused to a branch by an 'out of sync' issue as the overall cash in branch relating to the ATM remains the same.
- 7.17 In terms of the suggestion made at paragraph 7.22 that Subpostmasters were "*left to work out for themselves*" how to carry out the ATM related accounting on their branch Horizon system, this is incorrect.
- 7.18 On installation of an ATM, training on operating the ATM is provided by Wincor. When a Post Office branch which already has an ATM transfers to a new Subpostmaster, ATM training is provided by Post Office as part of its standard training package. Each branch is also provided with a Bank of Ireland ATM Operator Manual on how to use the ATM which includes descriptions of how to load cash into an ATM, how to obtain the ATM totals receipts and how to use the ATM's cash management menu.
- 7.19 Also, each branch is provided with 'Accounting Instructions for Bank of Ireland ATMs' which explains how activity on an ATM should subsequently be recorded by the Subpostmaster on Horizon.
- 7.20 If this is not sufficient or issues emerge, additional support can be accessed via the Network Business Support Centre (NBSC). If NBSC is unable to resolve the branch query/issue then

Confidential

further telephone support is provided by the Branch Support Team who will also assess whether additional on-site support and or training is required. If so, the Branch Support Team will arrange such support or training for the branch.

- 7.21 The suggestion at paragraph 7.23 that some Applicants would not have been aware of their repeated errors, and therefore would not have sought help from Post Office, is not supported by evidence. It would have been obvious to any Subpostmaster receiving multiple Transaction Corrections related to ATM accounting that they were making mistakes and that further support should be sought.
- 7.22 Again, however, it must be borne in mind that the Report does not explain how these accounting errors would actually cause a loss of physical cash from an ATM. In Post Office's view, and for the reasons stated above, they cannot.

#### **Accuracy of ATM figures**

- 7.23 At paragraph 7.8, the Report suggests that the data produced by an ATM is vulnerable to "*error and fraud*". Post Office notes that no case in the Scheme has presented any evidence to support Second Sight's view. In any event, there are further safeguards in place to detect either of the above:
- a. First, a Subpostmaster should check whether the cash-dispensed figure input by them on Horizon matches the cash-dispensed figure on the ATM receipt that they will have retained in branch. This will eliminate any human error or fraud through the incorrect entry of figures into Horizon by branch staff.
  - b. Secondly, each bank in the LINK ATM network would be checking the cash dispensed values for each ATM against the amounts drawn from an individual customer account. This ensures that every withdrawal from an ATM can be traced back to withdrawal from a customer's account. The aggregate of these individual withdrawals will match the total cash dispensed figure generated by the ATM. The Report acknowledges that this is a "*reliable control*" (see paragraph 7.33).
  - c. If the above two safeguards show the cash dispensed figure to be correct but there still is a loss of physical cash from an ATM, then a Subpostmaster can call on Post Office for assistance including where appropriate on-site support. The Report claims that Post Office does not investigate ATM-related discrepancies. Second Sight's misunderstanding in this regard may have arisen because no case in the Scheme gave

Confidential

rise to a need for such an investigation. In the majority of cases, the alleged ATM losses were shown to be accounting issues arising from, typically, the cash dispensed figure not being correctly inputted into Horizon.

- 7.24 In paragraph 7.11, the Report says that Second Sight has seen “*examples*” where the printed ATM-generated figures are false. As noted by the Report this was not however the cash dispensed figure mentioned above and was attributable to the Subpostmaster making repeated mistakes in operating the ATM. Ultimately, however, this erroneous figure was immaterial and did not affect the branch’s accounts. No evidence has been presented to support the Report’s view at paragraph 7.12 that the cash-dispensed figure can be corrupted.

#### **Power and telecommunication issues**

- 7.25 Paragraph 7.24 of the Report states that many Applicants have commented on the impact of power and telecommunications failures on the ATM. The Report acknowledges that, even when they have identified dates of power or telecommunications failures, Applicants cannot show that they caused specific deficiencies in their branches.
- 7.26 Despite this, the Report speculates that the need to re-boot the ATM by either the Subpostmaster or BOI could “*introduce a possible risk of data loss or corruption*”. This comment is not supported by any evidence either from a specific Applicant’s case or general evidence that such a problem may exist.
- 7.27 Although the Report states that Second Sight have “*not been able*” to conduct tests on Post Office’s ATMs to establish this point, it is noted that Second Sight has never asked Post Office if it could conduct such tests during the three years since its appointment.
- 7.28 Post Office remains confident that data cannot be corrupted by power or telecommunications failure as suggested in the Report.

#### **Fraud on ATMs**

- 7.29 The Report suggests that ATMs could be subject to fraud / theft that cause a loss of cash. Post Office accepts that ATMs are at risk of being subject to third party fraud. However, it is not aware of any form of fraud that creates a loss to Subpostmasters, provided they follow

Confidential

the correct accounting procedures. Losses caused by these frauds fall on Post Office, BOI or customers, not Subpostmasters.

7.30 The Report specifically raises the idea of malware being used to steal cash from an ATM, in particular, the possibility of self-deleting malware that is said to leave no footprint. The Report presents no evidence to support this allegation and no case in the Scheme indicates that this type of fraud may have occurred. It should be noted that the only access to the software of the ATM is through the ports on its rear. The rear of the ATM is in a locked and secured enclosure. Therefore any attempt to introduce malware would first require someone to physically gain access to the rear of the ATM. This would damage the enclosure allowing the malware / fraud to be identified.

7.31 Post Office's view remains that this is not an issue that causes loss to Subpostmasters.

### **Conclusion**

7.32 Overall, provided a Subpostmaster follows the appropriate procedures they will not be liable for any ATM loss due to an 'out of sync' problem or retract fraud. Post Office does not agree that the instructions and support in relation to ATMs are inadequate. No evidence is provided to support this position nor do the large number of ATMs across the Post Office network that are operated without concern appear to have been considered. This would support the position that the operating practices for ATMs are clear, understood and work in practice.

Confidential

### Post Office's response to section 8 – Motor Vehicle Licences

- 8.1 Section 8 of the Report considers the issuing of Motor Vehicle Licences (**MVL**). The Report itself notes that only a small number of Applicants reported problems concerning processing MVLs. It is not therefore clear that this can be considered a system-wide issue of general application.
- 8.2 Paragraph 8.1 describes a problem encountered (by what Post Office believes to be a single Applicant) when form V11C (the form used by customers to renew their MVL tax discs) was misprinted with the incorrect barcode. Form V11C is not produced by Post Office but by the Driver and Vehicle Licensing Agency (**DVLA**) and therefore this was an external error.
- 8.3 If there is an error with a barcode, the issue raised will relate to the tax banding. This issue could benefit or disadvantage a customer. However, Horizon would invite payment at the level requested by the barcode. Provided that payment was taken for the amount requested by Horizon the branch would not suffer a loss as there is no loss or gain from the transaction from the branch's and Post Office's perspective. Whilst this issue is clearly not desirable (and Post Office would offer all possible assistance to the customer to correct any error on the DVLA issued V11C form), this issue does not impact on branch accounting.
- 8.4 This appears to be a one off incident, caused by a barcode that was created by the DVLA.

Confidential

**Post Office's response to section 9 – Foreign Currency Transactions**

- 9.1 Section 9 of the Report discusses, and makes a number of assertions about, Post Office's "*system for transacting foreign currency transactions*" and reaches the conclusion that the accounting processes for foreign exchange transactions were "*fundamentally flawed*".
- 9.2 The allegations are made in relation to the Forde Money Changer (FMC) Machine which was used in branches until early 2004 to conduct foreign currency transactions. As far as Post Office is aware, of the Applicants that have referred to issues encountered with Foreign Currency transactions, only one relates to a time period when the transactions would have taken place on the FMC machine. This section of the Report does not therefore apply to anyone other than that single Applicant.
- 9.3 For the avoidance of doubt however, Post Office rejects the notion that the FMC was flawed. First, the Report does not explain what the 'flaw' is, nor does it explain how it would have impacted on Subpostmasters.
- 9.4 It appears the Report is alleging that because (until early 2004) Horizon did not record individual foreign currency transactions, but only bulk weekly totals, this meant that Post Office was at fault for any losses. Alternatively, it appears to say that because Post Office 'devalued' currency on its books there was not a real loss.
- 9.5 In both cases, this is incorrect. Any loss of foreign currency was not an accounting loss. No matter how the currency is valued or recorded, if physical notes of currency are missing from a branch, this will cause a real loss to Post Office.



Confidential

**Post Office's response to section 10 – National Lottery**

- 10.1 Section 10 concerns National Lottery transactions which are described in more detail at paragraph 5.35 of the Part One Briefing. In particular, the Report highlights alleged problems that Subpostmasters may have in relation to (1) scratchcards and their activation and (2) sales continuing outside of Post Office hours of Lottery products in a connected retail shop resulting on the Horizon and Camelot terminals being 'out of sync'.

**Activation of Scratchcards**

- 10.2 Paragraph 10.4 states, correctly, that before February 2012 any Lottery scratchcards received by a branch had to be manually 'activated' on a Camelot terminal and then remitted in to Horizon. This process is described in more detail at paragraph 5.42 of the Part One Briefing.
- 10.3 Paragraph 10.3 of the Report describes how a branch could become 'out of sync'. This means that the activation of scratchcards on the Camelot terminal did not reflect those remitted in to Horizon. This would result in either a surplus or a deficiency of scratchcard stock in the branch accounts. To remedy this error, Post Office and Camelot conducted daily reconciliations of the data on the Camelot terminal and on Horizon. Where there was a discrepancy, a Transaction Correction would be issued to the branch.
- 10.4 Any errors that occurred through the failure to activate or remit<sup>3</sup> in scratchcards were errors that occurred in branch owing to a failure by a Subpostmaster to follow the correct procedure.
- 10.5 However, the effect of not remitting in scratchcards into Horizon will not in itself create a loss. The physical scratchcard stock will still be in the branch as it must have been delivered to the branch for it to be activated on the Lottery terminal. The Transaction Correction only

---

<sup>3</sup> Branches send or receive cash and stock (to and from Post Office central processing centres. This movement of cash and stock is called a 'remittance' (and is often referred to as 'remming in' or 'remming out')



Confidential

increases the amount of scratchcards shown in the branch accounts to reflect the amount actually on hand.

- 10.6 If the scratchcards have been sold but not remitted into Horizon, the branch would show a negative stock value for scratchcards (as each sale reduces the stock line in the accounts even if this goes below zero). The subsequent Transaction Correction will therefore increase the scratchcard holdings, cancelling out the negative figure and bringing the accounts back into balance.
- 10.7 The opposite effect will happen if scratchcards have not been activated on the Lottery terminal but remitted into Horizon.
- 10.8 In summary, it is clear that this issue is caused by errors in branch for which Subpostmasters are responsible but that in any event this issue cannot be a source of actual losses.

### **Support**

- 10.9 At paragraph 10.8 the Report states that the problems encountered by the Applicants (prior to procedural improvements described at paragraph 5.43 of the Part One Briefing) were exacerbated by the Helpline which was not able to offer assistance. Post Office is not aware of the specific calls or incidents to which the Report is referring that are alleged to demonstrate a general failure to provide adequate advice.
- 10.10 This is an issue that will need to be considered on a case by case basis depending on the advice provided to an individual Applicant in a specific instance. However, as noted above, the reconciliation process conducted by Post Office means that any error would be corrected in due course.

### **Out of hours sales**

- 10.11 Paragraph 10.2 of the Report describes an alleged problem relating to the synchronising of sales that take place outside the hours when the Horizon system is operating at the Post Office counter. Sales of Lottery products (as described at paragraph 5.39 of the Part One Briefing) may continue while a connected retail shop is open but the Post Office counter is closed. However, the branch needs to ensure that any cash taken for any 'out of hours' sales is transferred from the retail shop to the branch cash holdings the following day.

Confidential

- 10.12 The value of the 'out of hours' sales (and any other sales) will be automatically sent to Horizon each day by way of a Transaction Acknowledgement which will increase the cash position in the branch's accounts. The amount of cash to be transferred from the retail side to the Post Office side is easily identified as the figure is displayed on the Transaction Acknowledgement. If a Subpostmaster does not transfer the physical cash from the retail side into the branch for these sales, this will produce a cash shortage in the branch's accounts. The Subpostmaster will be liable for this cash shortage at the end of the trading period.
- 10.13 Paragraph 10.9 of the Report highlights an alleged 'complication' occurring on the final Wednesday evening of the monthly trading period for those branches operating Lottery terminals. This is a reference to the trading period reconciliation completed on a monthly basis. Rather than process the reconciliation on a Wednesday evening as they would normally do, Subpostmasters with Lottery terminals have first to accept the Transaction Acknowledgement sent overnight and complete the reconciliation as a matter of priority the following morning. The Report states that advice on this process was not always provided by the Helpline.
- 10.14 Post Office has not seen any evidence to support this assertion and has provided Second Sight with call logs relating to individual Applicants' cases. However, no specific calls are referenced to support this statement.
- 10.15 In fact, branches operating a Lottery Terminal needed to make daily cash declarations (see paragraph 8.2 of the Part One Briefing) like all other branches. As Lottery sales data is sent overnight, Lottery branches are instructed to conduct their cash declarations and end of trading period balances (see paragraph 7.45 of the Part One Briefing) first thing in the morning after the Lottery data was received. This was not therefore a complication but an adjusted daily process for branches with Lottery terminals.
- 10.16 In practice, some branches chose not to follow 'next day' guidance and may have conducted balances several days later. However, Post Office operational instructions have always provided for next day accounting.
- 10.17 In summary, any loss arising from 'out of hours' issues highlighted in the Report will arise as a result of an error in the branch (for which a Subpostmaster is liable).

Confidential

## **Conclusion**

10.18 Procedures have evolved to assist Subpostmasters and reduce the number of Transaction Corrections that are necessary in relation to scratchcards, especially in relation to their activation. However, the 'out of sync' effect created by either incorrect activation or non-activation of scratchcards, or not correctly recording the out of hours' sales, are errors that arise within a branch. It is recognised that this error by branch staff can, in extreme cases, lead to a high number of Transaction Corrections being issued to a branch which, in turn, can cause confusion. However, this is easily resolved by running a separate Lottery stock unit so that Lottery issues do not affect general branch accounting. In any event, the errors were not caused by either Post Office or Horizon and therefore any liability appropriately remains with the Subpostmaster if it arises.

Confidential

**Post Office's response to section 11 – Training, Support and Supervision**

- 11.1 Section 11 principally considers the training on Horizon and branch accounting provided to Subpostmasters by Post Office. Currently, training for Subpostmasters consists of a mixture of classroom training and in-branch training. Further training is available upon request and there is a well-developed support network including the NBSC, managerial support and Field Support Advisors. This training and support is described in more detail at section 4 of the Part One Briefing.
- 11.2 Paragraph 11.2 of the Report comments that the training was adequate in relation to 'business as usual' transaction processing but was weak in relation to the end of day, end of week and end of trading period balancing. In addition, the Report states that there was no consideration given to dealing with discrepancies, how to identify the root causes of problems and how to deal with Transaction Corrections.
- 11.3 These views appear to be based entirely on the anecdotal information provided by Applicants in their CQRs. As noted in the introduction to this Reply, these assertions remain largely untested. Post Office has not been asked to provide any training materials for review nor has the Report established any industry standard or contractual benchmark against which to judge Post Office's performance. The limited analysis used to support the Report's conclusion is considered below and shown to be incorrect.
- 11.4 Given that the Report has presented no evidence or analysis that shows that Post Office's standard training is defective, Post Office stands by its training practices as being appropriate and effective. Post Office considers that the training and support that is provided is fit for purpose and adequate to meet the needs of Subpostmasters. This is proven by the thousands of Subpostmasters who are successfully operating Horizon daily, having received the training from Post Office.
- 11.5 There may of course be specific cases where training and support has not been provided to Post Office's usual standards (which is not impossible given the thousands of Subpostmasters trained and supported by Post Office over the years) but these situations will be considered on a case by case basis and are not reflective of any general issue.

Confidential

### **Move to Horizon**

- 11.6 At paragraphs 11.3 and 11.4, the Report finds that many Applicants found that discrepancies began to occur when they moved to Horizon. The conclusion reached in the Report is that this was due to a lack of understanding of how the system was due to operate and be used, meaning they were insufficiently trained, had not been able to train their staff properly or there were issues with the new screen-based processes.
- 11.7 Post Office does not agree with this conclusion and it appears to be unsupported by any evidence that fewer mistakes were made prior to the introduction of Horizon. Transaction records are not available for the pre-Horizon period and it is not possible to test the conclusion which is put forward. It therefore appears that the Report has accepted Applicants' anecdotal recollections of events without testing these for any corroborating evidence.

### **ATMs, Lottery transactions, MVL foreign currency or other specialist products**

- 11.8 At paragraph 11.6 the Report highlights that Applicants considered that the Post Office Trainers and Line Managers were weak in relation to dealing with ATMs; Lottery transactions; Motor Vehicle Licences; Foreign Currency and other products.
- 11.9 There is a lack of evidence to support these alleged comments from Applicants. Owing to document retention policies, training records for a number of Applicants are no longer available. There also appears to be no contemporaneous evidence that Applicants were not provided with adequate support by Trainers or Line Managers whether in relation to ATMs, Lottery transactions, MVL, foreign currency or other specialist products. If there was a lack of understanding in relation to these aspects, Post Office would expect the Subpostmasters to request further training or otherwise seek assistance through NBSC.

### **Training Needs Analysis**

- 11.10 Training support is provided through various means including the NBSC and managerial support. In addition, training materials are provided on a regular basis and further training can be requested by Subpostmasters.
- 11.11 The Report, at paragraphs 11.7 and 11.8 suggests that it is ineffective to rely on Subpostmasters to identify on-going training needs in their branches and that further

Confidential

training was delivered in accordance with user demand rather than being determined by a Training Needs Analysis. There are a number of factors that can affect a branch's performance and the need for training e.g. changes in an Applicant's assistants, changes in the way a Subpostmaster may operate his/her business, seasonal pressures, changes to the connected retail business etc. None of these factors will be known to Post Office but they will all be known to the Subpostmaster. Post Office therefore considers that it is most effective for each Subpostmaster to be tasked with seeking further training rather than it being proposed by Post Office.

- 11.12 Nonetheless, when Subpostmasters complete their training there are follow up reviews at one, three and six monthly intervals. In addition to confirming that the business is operating as it should be, there is an analysis of the Subpostmasters understanding. If there are any gaps, these are highlighted and further training can be provided. After this stage, there is a reasonable assumption that the Subpostmaster will be reasonably competent, with the support network highlighted above, to operate Horizon. Subpostmasters are operating a commercial business and can request additional assistance and training when required.

### **Training assistants**

- 11.13 As is made clear within the Contract (at section 15, paragraph 7) it is a Subpostmaster's responsibility to train his/her staff. Nevertheless, the Report criticises Post Office at paragraph 11.7 for not operating a "*quality control function*" to ensure that branch staff are properly trained by Subpostmasters.
- 11.14 The Report seeks to impose on Post Office a responsibility which it does not have under the Contract or generally.
- 11.15 Any failure by a Subpostmaster to train their staff adequately could be the reason for the losses or increase in discrepancies. However, any resulting losses would be a result of the Subpostmaster's error and he would be liable for them (under section 12, clause 12 of the Contract).
- 11.16 In any event, Post Office could not operate the quality control function proposed by the Report. Each Subpostmaster, as an independent business person, is free to employ whomever they wish as assistants (subject to registering them with Post Office) and to give their employees whatever tasks they wish.

Confidential

- 11.17 Furthermore, Post Office cannot monitor the performance of individual assistants it does not engage or employ; only Subpostmasters can do this.
- 11.18 Post Office agrees that a “*quality control function*” should be applied to assistants. However, this should be undertaken by Subpostmasters and not Post Office. Indeed, in a number of cases, losses appear to have stemmed from Applicants’ failures to exercise any ‘quality controls’ over the actions of their staff.

Confidential

**Post Office's response to section 12 – The Helpline**

- 12.1 Section 12 concerns the assistance provided by the Helpline to the Applicants. Post Office operates a number of helplines including the Horizon Help Desk and Finance Services Centre. It is presumed that the Report is referring to the NBSC. More detail on the Helpline can be found at paragraph 4.2 of the Part One Briefing.
- 12.2 The following criticisms of the Helpline are made in the Report:
- a. difficulty contacting the Helpline owing to limited availability;
  - b. unhelpful, script based responses; and
  - c. contradictory advice that revokes previous advice.
- 12.3 This section of the Report repeats the assertions made by Applicants. Those allegations appear untested and the Report reaches no conclusion save to say that *“many of the shortfalls were, on the balance of probabilities, attributable to errors made at the counter”* and whilst it may not be what Applicants expected, *“... Post Office’s Chesterfield-based Helpline staff cannot be expected to determine from afar how every discrepancy has arisen in every branch...”*.

**Difficulty contacting the Helpline owing to limited availability**

- 12.4 Post Office has previously acknowledged that as changes were made to standard operating practices over the years there have been periods where the Helpline could be difficult to contact. Changes were made, especially at the end of trading periods, and the hours for which the Helpline was available were extended.
- 12.5 The opening times for the Helpline are currently from 06:00 to 23:00 on Monday to Saturday and 07:00 to 17:00 on Sunday and Bank Holidays. Post Office monitors the number of calls made to the Helpline and response times so that it can adapt the Helpline opening hours and resources to meet the needs of Subpostmasters.



Confidential

### **Unhelpful, script based responses**

12.6 The Helpline does not use scripts. The operators, many of whom are very experienced with Horizon, listen to the query and then, using 'categorisations' in Remedy (the contact management system), the Post Office Knowledge Base is accessed, where there are articles relating to that category of call. The operator then selects the relevant article according to the issue raised by the caller and relays the information to them. If the Knowledge Base does not provide the relevant information there is a second tier of advisors to whom the enquiry can be escalated.

### **Alleged contradictory advice**

12.7 No evidence is presented in the Report to support the view that contradictory advice has been given by the Helpline.

### **General**

12.8 All calls to the Helpline are recorded by the Helpline operators in the NBSC call logs. The logs describe briefly the nature of the question and the answer given, if appropriate. The Report states that there is insufficient evidence within the call logs that have been provided to them to conclude what advice was provided. However, Post Office considers that if calls were not being answered or addressed appropriately then either the matters would be escalated (which would be noted) or there would be repeated calls about the issue that the Subpostmaster was facing. There would be evidence that the advice had not resolved the problem or the Applicant was not happy with the advice. The absence of such evidence suggests that the calls had generally been resolved satisfactorily whilst accepting that there may have been individual calls where an Applicant was not content with the advice provided.

12.9 At paragraph 12.2, the Report states that a frequent comment by the Helpline was that matters would resolve themselves. It is likely that this was reference by the Helpline to a Transaction Correction potentially being generated following a surplus or deficiency and that would resolve the issue.

12.10 Through its own investigations, Post Office has found no evidence to support the allegations that the Helpline would often merely comment that matters would resolve themselves or be dismissive of any enquiry. In addition to the initial advice from the Helpline, if matters could

Confidential

not be resolved they could be escalated to a higher level of support. Support could have been provided by Field Support Advisors or managerial support if it had been requested. Post Office is not aware of any wider systemic problems where this support was not being provided.

Confidential

### **Post Office's response to section 13 – Limitations in the Transactional 'Audit Trail'**

- 13.1 Section 13 of the Report considers what it generically refers to as "*limitations in audit trails*". The Report is concerned that Subpostmasters are not able to investigate the root cause of errors (even where they admit it is caused by their own, or an in-branch, error) owing to a lack of access to necessary transaction data.
- 13.2 The Report considers three situations:
- a. data that is not available on the day of the transaction under investigation;
  - b. data that is available but after 42 / 60 days is no longer available; and
  - c. data that is not available after suspension.
- 13.3 In general, Post Office considers this section is premised on a misunderstanding of the nature of the information needed by branches to investigate losses.
- 13.4 If, at the end of a day, a branch produces a cash declaration that shows a discrepancy, then the branch will have access to a range of reports on different products and transactions to investigate the possible causes for the discrepancy (including a complete line by line listing of all transactions that day). This also applies at the end of the trading period as a trading period is either 4 or 5 weeks (28 or 35 days) and the above reports and data have always been available in branch for a minimum of 42 days.
- 13.5 If a Transaction Correction is sent to the branch, the information needed to verify the Correction will not be the Horizon data (Post Office has this data and takes this into account when generating the Transaction Correction). The information is likely to be in the paper records held at the branch.

### **Data that is not available even from the day of transaction**

- 13.6 Paragraphs 13.4 to 13.8 of the Report raise the issue that some information is not available to Subpostmasters even on the day that a transaction takes place. The example provided in the Report is where an aggregate amount or volume is provided for Debit or Credit Card

Confidential

transactions. An aggregate amount for the number of transactions was provided at the end of each day rather than a breakdown of the individual transactions. As a result, the Report states that Subpostmasters are not able to identify the individual transaction that may have caused a balancing error. The Report considers that this would prevent a Subpostmaster from mitigating their loss or remedying the error by contacting the customer. This position was allegedly different prior to the introduction of Horizon when paper records were kept and could be reviewed.

- 13.7 Post Office does not understand this line of enquiry. Debit and credit card information has never been retained on Horizon in branch – indeed doing so would be a breach of Payment Card Industry standards (and Horizon is PCI accredited). However, as mentioned above, branches have always had access to line by line transaction data each day and this data records the method of payment (e.g. cash, cheque or card).

**Data that is available but after 42 days is no longer available (this was extended to 60 days)**

- 13.8 On the original Horizon system, line by line transaction data was available in branch for 42 days after a transaction occurred. On Horizon Online (since 2010), this data is available for 60 days.
- 13.9 The Report considers that with data only being available for a limited period of time, it may not be available to support a challenge by a Subpostmaster to a Transaction Correction that may be issued after the date that data can be retrieved (i.e. beyond 42 or 60 days). The Report states that this restricts Subpostmasters' ability to challenge Transaction Corrections.
- 13.10 What the Report does not take into consideration is that Subpostmasters may challenge a Transaction Correction without transaction data. Transaction Corrections are also often preceded by an enquiry and so even if the Transaction Correction is beyond 42/60 days then an enquiry may well have been received within the period enabling the matter to be investigated within the 42/60 day period. There is a wide range of evidence that can be provided to review or challenge a Transaction Correction. Often it is very product-specific and not a general view across all data entries. Typically, the necessary data is kept in branch records rather than on Horizon. These hardcopy documents should be retained beyond the period that data is available through Horizon and is used by Subpostmasters to challenge or review a Transaction Correction.

Confidential

13.11 For example, if a branch wishes to contest a Transaction Correction relating to ATM transactions (see section 8 above), the information needed is on the paper 'Totals Receipt' printed daily by the ATM which shows how much cash has been dispensed by the ATM and other important information. This receipt must be retained in branch. No access to Horizon data is needed as all the necessary information is on the 'Totals Receipt'.

13.12 Post Office is confident that it will be able to show that sufficient information is available to Subpostmasters in relation to any specific product, transaction or process.

#### **Data that is not available after suspension**

13.13 Paragraph 13.15 of the Report highlights that some Applicants were, following their suspension, refused access to data and their own records that may have been seized upon audit. As a result they say that they were unable to defend themselves from any claim made by Post Office for the recovery of monies.

13.14 Whilst Post Office is aware that some Applicants have raised the issue that their own records were removed and not returned to them, there is no evidence produced or referenced by the Report to support the position that this has prejudiced an Applicant in any way.

13.15 As to other branch records, these are the property of Post Office. In the event of a Subpostmaster being suspended, Post Office may take away some branch records for investigation.

#### **Giro Transactions**

13.16 A connected issue that is considered at paragraph 20.4 of the Report is the process relating to Giro Transactions (under the heading 'other counter-errors that benefit customers at the expense of the Subpostmaster'). Giro Transactions are, in essence, deposits of cash into a customer's bank account. Previously, this involved a two-part paying in slip with one copy retained by the customer and the other accepted by the branch and then despatched to the processing bank (Santander) with the last Royal Mail collection of the day. At the end of the day, the branch copy could be cross-referenced to the entry made on Horizon to check for any errors by the branch in keying in the wrong figure into Horizon. This process changed to a chip and pin system using a swipe card at the request of the processing bank (Santander)

Confidential

that ran the Giro banking service. Following the change, no paying in slip would be presented by the customer.

- 13.17 The Report states that owing to the change in this process there is nothing to allow the Subpostmaster to check whether or not the cash deposit entries on Horizon reflected the amount of cash deposited and this increases the risk to Subpostmasters. This is incorrect.
- 13.18 In terms of the accuracy of the accounting entries for the deposit, historically, with paying-in slips, there was a risk that the deposit value on Horizon (as manually keyed in) and the actual amount deposited to the customer's account (as per the paying in slip) could differ and generate a discrepancy. Hence the need for the end of day cross-check. Under the chip and pin system, there is less likely be an accounting error as the amount entered into Horizon by the Subpostmaster is confirmed on the chip and pin pad by the customer. Therefore the amount deposited to the customer's account is always the same as the amount on Horizon. The move to chip and pin has therefore eliminated the risk of an accounting discrepancy.
- 13.19 However, if a branch takes more or less cash than the recorded value of the deposit, then that is a cash handling error for which the branch is responsible. Even with a paying-in slip, there was no guarantee that the amount of physical cash handed over by a customer was accurate. The paying-in slip only evidences what the customer intends to deposit (assuming it is completed correctly); it does not evidence the amount of physical cash handed over (which could still have been mistakenly counted). The only check that can be conducted to ensure the correct amount of physical cash is taken from a customer is a manual cash count at the point of the transaction. This manual cash count is needed whether the deposit is by paying in slip or chip and pin card. Any discrepancy arising from a cash counting error therefore lies solely on the branch.
- 13.20 This is the same process used by all high street banks which have also moved away from paying in slips to card based deposits.

Confidential

**Post Office's response to section 14 – Transactions not entered by Subpostmaster or their Staff**

- 14.1 Section 14 of the Report considers, at paragraphs 14.1-14.3 transactions that have not been entered by the Subpostmaster or their staff such as where there is an 'automated transactional reversal'. This appears to be the same underlying issue as raised in section 15 – see that section for Post Office's reply.
- 14.2 Paragraphs 14.4 and 14.6 allege that there may be/have been a facility in Bracknell where Post Office can edit transactions without the knowledge of Subpostmasters. This is rejected in the strongest possible terms. The Subpostmaster who alleges to have witnessed this was a member of the NFSP and was on an escorted visit of a Fujitsu site. He saw a room with Horizon terminals but these were test terminals, not connected to the main Horizon network. What he saw was the manipulation of test data in a test environment. This then appears to have been confused with what cannot, in fact, happen. Post Office has provided Second Sight with a witness statement from the senior member of staff who escorted the Subpostmaster on the visit, who has confirmed the above.
- 14.3 For clarity, neither Post Office nor Fujitsu can edit the transactions as recorded by branches. Robust safeguards are in place to ensure the integrity of the data sent by branch terminals to the Post Office data centre – these are set out in detail at section 22 below. Although some Applicants have suggested that they have seen mysterious transactions that they cannot explain, multiple explanations have been found to show how these transactions can, in fact, straightforwardly be explained (e.g. a miskeying error, attached to the wrong stock unit, logged in using someone else's ID, etc.).
- 14.4 At paragraph 14.10, the Report refers to two Post Office / Fujitsu documents that relate to a 'Receipts / Payments' issue that affected a small number of branches that were the pilot branches for Horizon Online in 2010. This issue was disclosed to Second Sight back in 2013 and was considered in Second Sight's Interim Report. These documents inaccurately refer to Post Office "*altering*" transaction data in order to correct an error in branches.
- 14.5 It has always been possible for Post Office to correct errors in and/or update a branch's accounts. This is most commonly done by way of a transaction correction. However, it could also be by way of a balancing transaction or transaction acknowledgement. In the case of

Confidential

the 'Receipts / Payments' issue, the error in one branch was corrected by use of a balancing transaction, whilst Post Office absorbed the losses affecting the other branches.

- 14.6 All of these processes for correcting / updating a branch's accounts have similar features. All of them involve inputting a new transaction into the branch's records (not editing or removing any previous transactions) and all are shown transparently in the branch transaction records available to Subpostmasters (as well as in the master ARQ data).



Confidential

### **Post Office's response to section 15 – Transaction Reversals**

- 15.1 Section 15 of the Report considers the issue of Transaction Reversals.
- 15.2 Transaction Reversals are where part of a basket of transactions is reversed because the basket is interrupted before completion (typically due to a power or communication failure).
- 15.3 The Report states that when a Transaction Reversal happens, Horizon records the reversal against the user ID of the Subpostmaster or a member of staff. The Report states that this is misleading because the reversal is 'automatic'. This interpretation is incorrect.
- 15.4 As far as Post Office is aware, this issue has only been raised as part of a Spot Review conducted by Second Sight whilst preparing its Interim Report. The Subpostmaster who raised the issue which was subject of the Spot Review decided not to make an Application to the Scheme and no other Applicant has raised this issue.
- 15.5 As detailed in Post Office's response to the Spot Review (full details of which are confidential in order to protect the privacy of the Subpostmaster whom it concerned), the reversals were caused by the Subpostmaster cancelling a number of transactions that they were conducting for a customer. The user's System ID is shown as the person making the reversal because they initiated the reversal process.
- 15.6 The extracts taken from the report by Helen Rose (as quoted at paragraph 15.3) are taken out of context. The report was addressing concerns that reversals were not being clearly shown on the particular data being reviewed (i.e. the ARQ and credence data being the main transaction data used by Post Office). However, this data is available on other records that can be extracted from Horizon. The report makes clear that this is not an issue with Horizon itself or its data but the way that the data it produced was presented within one particular data log. It does not suggest that there was any entry being made that was not initiated within the branch by the Subpostmaster or their staff.
- 15.7 This section raises no issue that could be the cause of losses in a branch.

Confidential

**Post Office's response to section 16 – Cash and Stock Remittances (Rems) in and out of the branch**

- 16.1 Section 16 of the Report focuses on the remittance of cash and stock to and from branches. Paragraphs 7.16 to 7.29 of the Part One Briefing describe the remittance process.
- 16.2 On occasion, issues can arise such as cash pouches not being received or there being less or more cash within the pouch than stated. This will result in a Transaction Correction being raised.
- 16.3 If the cash centre remits a cash pouch to a branch and it is not received this will not result in a loss to the branch. The cash centre will investigate why the pouch has not arrived and ultimately bear the loss. The cash pouch is scanned upon receipt by the branch and therefore it is only at this stage that the cash is registered on Horizon as being held in branch. From this point, any loss of cash is the responsibility of the branch and the Subpostmaster. There may be some occasions when the pouch barcode will not scan. In such circumstances the pouch is entered as received manually by keying in the barcode number.
- 16.4 If there is more cash within the pouch than stated, the branch should report this within 24 hours of receipt. This will result in a surplus to the branch and a Transaction Correction is issued to correct the balance on Horizon.
- 16.5 In circumstances where the pouch contains less cash than expected, the matter should be reported by the Subpostmaster within 24 hours of receipt. The issue is investigated by the Post Office cash centre. If the cash centre accepts that the pouch contains less cash due to their error, they will bear the loss (if any). A Transaction Correction is issued to the branch to correct the balance on Horizon.
- 16.6 Where the cash centre does not accept that it is their error, the Subpostmaster is invited to review the security cameras that monitor the loading of cash into the pouch at the cash centre. If the Subpostmaster wishes to continue to challenge the amount received they can do so through the FSC in the same way that a Transaction Correction is challenged. If less cash is held on Horizon, a Transaction Correction would be issued.

Confidential

- 16.7 A similar process is applied when cash is remitted to the cash centre from the branch. The amount of cash sent within the pouch is recorded. If this sum is more or less than anticipated when received by the cash centre the issue is investigated. The Subpostmaster has the opportunity to view security cameras that monitor the movement of the pouch and can choose to accept the shortfall/surplus or place the loss/gain into the Suspense Account and investigate the matter further.
- 16.8 Paragraph 16.4 deals specifically with the instances where foreign currency has been accidentally sent to the wrong branch. The Report speculates that this could result in a Subpostmaster being responsible for a delivery that was never received.
- 16.9 The same process outlined above applies to foreign currency. If a pouch is not received by a branch it will not be scanned into Horizon and there will be no increase in cash holdings. If the pouch is not received there is no loss to the branch.
- 16.10 Where the pouch is taken to a different branch in error it can be rejected and will be returned to the cash centre. If an alternative branch accepts the pouch it will be scanned into Horizon and increase the foreign currency held at that branch. Transaction Corrections will be issued to correct any discrepancies that may have been created but overall there would be no loss to either the branch that received the foreign currency or the branch that accepted it.

Confidential

**Post Office's response to section 17 – Missing Cheques**

- 17.1 Section 17 of the Report discusses the process of remitting cheques from branches to Post Office's cheque processing provider. It considers the situations where cheques go missing and do not reach the cheque processor or cannot be processed by the customer's bank.
- 17.2 To assist Applicants, Post Office has set out below the cheque remittance process and the process followed when cheques go missing or bounce.
- 17.3 In summary, it is inevitable that cheques will occasionally go missing at some stage in their processing. However, as stated in paragraph 17.9, provided that the Subpostmaster follows the correct procedure for processing the cheques in branch, this will not result in a loss to them. The cost of a lost or bounced cheque is only passed to a Subpostmaster where there is clear evidence that the Subpostmaster has failed to follow proper acceptance or remittance processes and Post Office has exhausted all other possibilities of recovering the missing cheque. This is done in accordance with clause 12, section 12 of the Contract under which the Subpostmaster is liable for any losses caused by carelessness, negligence or error.

**Process in branch**

- 17.4 Most Post Office branches are entitled to accept cheques from customers as the method of payment for a range of designated transactions. The cheque should be scrutinised by branch staff to make sure it is not a forgery and the reverse of the cheque needs to be date stamped, initialled and the relevant transaction details recorded. This will enable identification of the specific product and/or customer in the event of an error. There may be no customer details recorded on Horizon against the cheque transaction, hence the need to endorse the cheque with those details.
- 17.5 The method of payment (**MOP**) by way of cheque should be recorded on Horizon. When recording a MOP as by cheque, the customer's cheque is automatically recorded on Horizon as a part of the branch stock.
- 17.6 All cheques taken should be despatched from the branch via the final Royal Mail collection of the day (except Fridays). The branch process for remitting cheques is as follows:

## Confidential

- a. Subpostmaster produces a cheque listing report from Horizon (which shows the value of each cheque accepted that day – or more accurately since the cheque listing was last cut off which should happen every day – see step e. below).
- b. Subpostmaster verifies that the cheques held in the till match (volume and value) against the cheque listing report.
- c. The total cheque value is then marked on Horizon as being remitted to POL (known as 'remmed out').
- d. A further cheque listing report is then produced. This will show the cheques being 'remmed' out as a negative value and the report will now total zero.
- e. The cheque listing report is 'cut off'. This effectively draws a line under the day's cheque payments and any further cheques taken after the cut off point will be logged against the next day's trading. The branch cheque stock will now show as zero.
- f. A Batch Control Voucher (**BCV**) is manually completed to show number of cheques, value and despatching branch. The cheques are attached to the BCV. The cheques are then despatched for processing in the relevant envelope via Royal Mail to the cheque processor.
- g. Horizon cheque listings and remittance slips are retained in branch.

**FSC process**

- 17.7 The POLSAP finance system at the FSC is automatically updated each night from Horizon (for the values of cheques remmed out from branches). The cheque team in FSC is able to view this data the day after the transactions and will see the outward remittances recorded.
- 17.8 Similarly, an electronic file will be received overnight by FSC from the cheque processor via an automatic upload into POLSAP which shows the actual cheques received from each branch. FSC can then compare the values recorded by the branch as despatched against the values recorded by the cheque processor as received.
- 17.9 Approximately 1,000 entries will remain unmatched each day (i.e. there is a discrepancy between the cheques received by the cheque processor and the information sent via Horizon by Subpostmasters about cheque remittances) and could be an indication of missing cheques.

Confidential

Many cases are resolved quickly (e.g. late delivery by Royal Mail or the Subpostmaster missed the collection or forgot to put a cheque in a pouch). There will be around 100 cases per month where it becomes apparent that a cheque has actually gone 'missing'.

### **Investigating lost cheques**

- 17.10 It is acknowledged that a cheque loss could occur at the branch, in the Royal Mail pipeline or at the cheque processor. Post Office's policy is that a branch will only bear the cost of a lost cheque if the branch has not followed proper procedures. If the root cause of a lost cheque is unknown or attributed to some other cause outside the branch, Post Office will absorb this loss and not pass it on to the Subpostmaster.
- 17.11 In the vast majority of cases, Post Office either mitigates the loss caused by a lost cheque or absorbs the loss itself. Only a very small number of missing cheque cases result in Transaction Corrections being issued to a branch.
- 17.12 The process for investigating missing cheques is as follows:
- a. The transaction to which a missing cheque relates is (if possible) identified from the information inputted into Horizon by the Subpostmaster.
  - b. Branches will be contacted when the missing cheque case is set up to see if the cheque can be found in branch or if they are aware of which customer presented the cheque which has subsequently gone missing.
  - c. If the branch cannot find the lost cheque, a variety of techniques (depending on product/information available) are employed to identify the customer and their address from the transaction data.
  - d. The customer is then contacted to request a replacement cheque. If a replacement cheque is provided then the loss to Post Office is avoided.
  - e. If a replacement cheque is not forthcoming, the relevant client organisation (i.e. the product supplier, say Bank of Ireland, Environment Agency, etc.) is informed that the payment for that particular transaction has not been received and the transaction is reversed where possible. By reversing the transaction the loss to Post Office is avoided.

Confidential

- f. Alternatively, if Post Office is unable to identify the customer details, the relevant client organisation may be asked to try to contact the customer directly for payment. By payment being made direct from the customer to the client, the loss to Post Office is avoided.
- g. If the transaction related to the missing cheque cannot be identified or if the transaction is identifiable but payment cannot be recovered from the customer or the client and the transaction cannot be reversed, Post Office will absorb the loss of the cheque provided discussions with the branch and a review of transactional data does not reveal a breach of the operational processes.

17.13 There are two typical scenarios where Subpostmasters have failed to follow operational processes and will be held liable for missing cheques:

- a. Cheques have been accepted by the Subpostmaster for a non-cheque acceptable product. Post Office's client determines the method of payment they will accept for the product or service they are selling through the Post Office and this is detailed in the operational instructions to branches. Typically, where the service/product is cash or instantaneous, then cheques are not acceptable (e.g. foreign exchange sales) because if these cheques are then not honoured, the service/cash has already been provided/taken place and cannot be stopped or recovered.
- b. The method of payment has not been correctly recorded on Horizon with the cheque as the MOP and it subsequently proves impossible to associate any transactions with the missing cheque. Such an instance will typically be illustrated by branches recording multiple/all transactions through 'Fast Cash' and then introducing a bulk cheque value to Horizon via a 'Cash/Cheque Adjustment' at the end of the day prior to remitting out. Again, this may frustrate Post Office's usual loss mitigation steps described above.

17.14 Where a Subpostmaster is held liable for a missing cheque, a Transaction Correction will be sent to the branch reversing the remittance of the cheque by the branch. This will return the value of the 'missing' cheque to the branch's cheque stock. If the branch cannot obtain a replacement cheque from the customer, there will be a cheque shortage at the end of the trading period that the Subpostmaster will need to make good.



Confidential

### **Bounced cheques**

- 17.15 Paragraph 17.4 makes reference to specific complaints by Applicants (rather than it being a common theme amongst Applicants) that they were liable for cheques that bounced. As described above, the branch accounts treat cheques like a stock item. So long as the branch accurately records the receipt of cheques from customers and the remittance of cheques to Post Office, then the branch is not concerned with the banking of any cheques. The banking of cheques and recovery of payment from customer's bank is conducted by FSC. Post Office absorbs the credit risk posed by accepting payment by cheque and should a cheque bounce, Post Office will absorb the resulting loss.
- 17.16 The only exception to this rule is where the branch has failed to follow operational procedures. This may have included not completing the transaction details in accordance with a cheque guarantee card (until these ceased in 2011) or taking payment for a product where payment by cheque is not permitted.

### **Transaction Corrections for missing or bounced cheques**

- 17.17 Paragraph 17.8 makes reference to Applicants not being able to mitigate their losses as the Transaction Correction for a missing or bounced cheque has been sent to them too long after they accepted the cheque. Transaction Corrections may be delayed on occasions but this is not the fault of Post Office. In some instances Post Office is dependent on a response from a third party (such as the customer's bank) before the Transaction Correction can be issued. This may have resulted in some delay but, as stated above, if the correct process is followed then Subpostmasters will not be liable for any lost or bounced cheques.
- 17.18 Typically, however, if there is an issue with a cheque, that issue will be raised with the branch through other channels. In most cases, the branch will be aware of the issue long before the Transaction Correction is submitted.

### **Evolving practices**

- 17.19 At paragraph 17.5, the Report suggests that Subpostmaster practices have "*evolved*" because Post Office has not expanded the range of products for which cheques should be acceptable. This causes Subpostmasters to break Post Office procedures and makes them liable for missing or bounced cheques. This idea is based on the flawed assumption that Post Office's



Confidential

cheque practices should 'evolve' to suit individual branch practices. In fact, Post Office's cheque practices have remained consistent. It is simply that some Subpostmasters decide not to follow the correct procedures in certain circumstances. Where they take that risk, they are responsible for any resulting losses.

Confidential

**Post Office's response to section 18 – Pensions and Allowances**

- 18.1 Section 18 of the Report concerns the risk of fraud taking place in relation to Pensions and Allowances (**P&A**) transactions. In particular, the Report states that Subpostmasters could be innocent victims of this type of fraud but still liable for the resulting losses in their branches.
- 18.2 For the reasons set out below, P&A fraud by branch staff can be easily detected by a Subpostmaster before any loss occurs so long as he/she is carrying out proper end of day checks on P&A transactions. Subpostmasters are therefore liable for any losses in their branch caused by P&A fraud as this loss arises due to their failure to conduct adequate checks.

**Benefit payment methods**

- 18.3 There are various methods by which benefits can be received by customers.

P&A books

- 18.4 P&A books were provided by the Department of Work and Pensions (**DWP**) to customers entitled to benefits. A nominated Post Office branch was set out on the cover of each P&A book, together with the customer's name and address. Within each book were (usually) 20 dockets, vouchers or foils (referred to in this Reply as 'vouchers') stating the FAD code of the nominated Post Office branch, voucher number and amount to be paid. The vouchers were presented to the branch staff, processed through Horizon and then cash paid to the customer. The vouchers were despatched each week by each branch to the Paid Order Unit (which in effect is the DWP) in Lisahally, Northern Ireland.
- 18.5 P&A books ceased to be used in circa 2005 and were replaced by the Post Office Card Account.

Post Office Card Account (POCA)

- 18.6 POCA is a limited service bank account that only allows benefits to be deposited into the account by DWP and cash to be withdrawn. Withdrawals are conducted by the customer

Confidential

taking his POCA card into a Post Office and withdrawing in cash either some or all of the benefits within his account.

#### Green Giros

- 18.7 Customers who lose their POCA cards or customers who are on temporary benefits may be sent 'Green Giros' by the DWP.
- 18.8 These are cheques (also known as DWP cheques) which set out the payment amount and can be cashed in the usual way. These cheques are date stamped and retained by Post Office after paying the customer. They have historically been accounted for and despatched by each branch weekly to Alliance & Leicester. They are now sent to Santander (both banks are referred to in this note as Santander for ease of reference). Green Giros should not be confused with Giro Payments which are an entirely different product.

#### P&A fraud

- 18.9 P&A fraud encompasses a number of different types of fraud, some of which are historical due to the change in payment methods over time.

#### 'Overclaim' fraud

- 18.10 For each benefit payment to a customer recorded on Horizon, the branch should take from the customer the associated P&A voucher or cheque and remit each week all vouchers to the DWP and all Green Giro cheques to Santander. An 'overclaim' occurs when the branch records a benefit payment on Horizon but does not remit the associated voucher or cheque. Without the voucher/cheque, Post Office cannot recover the payment from DWP/Santander. This places a loss on Post Office which is then passed to the branch by way of a Transaction Correction.
- 18.11 'Overclaims' are relatively easy to identify as the branch must record the remittance of vouchers or cheques out of the branch on Horizon and therefore it is possible to identify any missing weekly remittance.
- 18.12 A fraud can be committed by recording fake benefit pay-outs on Horizon, which lowers the amount of cash recorded as being in the branch (as Horizon assumes the cash has been passed to the customer). This causes a short term surplus (until the missing voucher/cheque

Confidential

is discovered and a Transaction Correction is sent through) which can be used to cover other losses or removed from the branch at the end of trading period (assuming that there are no other offsetting losses).

### **Reintroduction fraud**

- 18.13 Reintroduction fraud is a more sophisticated version of 'overclaim' fraud whereby the false benefit pay-outs are disguised by the submission of duplicate paperwork.
- 18.14 In reintroduction fraud, a legitimate benefit pay-out is recorded on Horizon with cash being paid to a customer but with the corresponding voucher/cheque not being date-stamped or remitted out to DWP/Santander. At a later date (typically the following week), the same benefit pay-out is recorded again on Horizon. This time, however, no cash is paid to a customer (as the customer is not present) but the previous voucher/cheque is date-stamped at the later date and remitted to DWP/Santander.
- 18.15 For example, in week 1 there would appear to be an 'overclaim' (amount claimed but no corresponding voucher or cheque). The amount would be claimed again in week 2 by submitting the cheque or voucher from week 1 (by this time date-stamped). The fraud is premised on DWP/Santander not spotting the missing voucher or cheque in week 1 or the reintroduced voucher/cheque in week 2. However, in practice, each voucher/cheque has a unique reference number which allows duplicate paperwork to be identified.
- 18.16 Each of these frauds has taken place both before the introduction of Horizon and when Horizon was in operation in Post Office branches. This is not a Horizon related issue. It is also largely an historic issue as most benefit payments are now through POCA's (which are not susceptible to the above frauds) although some Green Giro Cheques are still processed in branches.

### **Fraud prevention in branch**

- 18.17 It should be noted that 'overclaims' and 'reintroductions' will not cause a loss to a branch. They generate a cash surplus which, as long as the cash has not been removed from the branch, will off-set any later Transaction Correction.
- 18.18 It was possible historically – and remains open to a Subpostmaster now – to carry out immediate checks for P&A fraud as a Subpostmaster will have access to: (i) each week's

Confidential

batch of cheques/vouchers and (ii) that week's records of P&A transactions as recorded on Horizon. It is therefore possible for a Subpostmaster to easily confirm that the value of the cheques and vouchers being remitted each week match the value of benefit pay-outs recorded on Horizon. This would reveal any 'overclaims' or 'reintroductions'.

- 18.19 For this reason, Post Office does not consider that a Subpostmaster could be the innocent victim of P&A fraud. If a Subpostmaster does not follow the proper process for remitting out P&A documents, and thereby fails to stop any 'overclaims' or 'reintroductions' at source, they are liable for any resulting losses (if in fact any occur).

Confidential

**Post Office's response to section 19 – Surpluses**

- 19.1 Section 19 of the Report considers Post Office's approach towards the surpluses that may be generated within branches.
- 19.2 As stated at paragraph 19.1, the contract between Post Office and Subpostmasters allows surpluses to be withdrawn provided that any subsequent charge is made good immediately. This means that Subpostmasters may retain surpluses that may be generated. The Report confirms, correctly, that Post Office views both surpluses and deficits as discrepancies. However, the Report arrives at the incorrect conclusion that Post Office is not as concerned with surpluses as they are with deficits.
- 19.3 Whenever Post Office discovers a discrepancy that can be attributed to an error in branch, whether it is a surplus or a deficit, it will generate a Transaction Correction to correct the branch's accounts.
- 19.4 Where discrepancies occur in branch (say at the end of a trading period where there is a shortage or a surplus of stock or cash), it is for the Subpostmaster to dispute the discrepancy. This is done by contacting the NBSC. As there are more challenges to deficit discrepancies (and debit Transaction Corrections), Post Office spends more time investigating deficits than surpluses.
- 19.5 The system processes six million transactions every working day. Post Office only investigates a discrepancy in branch if the Subpostmaster requests assistance – it does not investigate every discrepancy identified in a branch's accounts for the following reasons:
- a. first, most discrepancies are fairly small and so do not warrant a full investigation unless the Subpostmaster raises an issue.
  - b. secondly, the sheer volume of discrepancies would make investigating them all unworkable.
  - c. thirdly, where a discrepancy arises in branch (i.e. the cash on hand does not match the cash figure on Horizon) an investigation will require close involvement of the Subpostmaster and their staff as only they will know how the branch has transacted its business. It would be inappropriate for Post Office to impose an investigation on a

Confidential

branch where the Subpostmaster is not raising any complaint and is prepared to bear the loss / surplus.

- 19.6 The Report's conclusion that Post Office is not concerned with surpluses is therefore not correct. In any event, it is noted that this topic does not give rise to any general issue that indicates Post Office or Horizon is responsible for losses caused in branches.

Confidential

**Post Office's response to section 20 – Counter-errors that benefit customers at the expense of the Subpostmaster**

- 20.1 Section 20 of the Report considers occasions when customers may benefit from certain errors in branch to the detriment of Subpostmasters. This section does not give rise to any general issue but rather appears to be the amalgamation of a series of discrete points.
- 20.2 Paragraph 20.1 of the Report highlights that mistakes can occur when a counter clerk presses the 'deposit' icon rather than the adjacent 'withdrawal' icon. This error by a Subpostmaster or their staff would have the effect of doubling the size of the error (as the branch will record the receipt of money into the branch in the accounts which increases the recorded cash position but will have also handed over cash to the customer thereby lowering the amount of cash in the branch).
- 20.3 Post Office agrees that this error may occur but this would clearly be an error within the branch, not a systemic problem with Horizon. In these circumstances the Subpostmaster would be liable for the error and any loss that has been created in accordance with section 12, clause 12 of the Subpostmaster contract.
- 20.4 Paragraphs 20.2 and 20.3 are a repetition of the issue raised in section 22 – on which point, see Post Office's comments on that section.
- 20.5 Paragraphs 20.4 – 20.7 are a repetition of the issue raised at paragraph 13.1 – on which point, see Post Office's comments on that section.



Confidential

### Post Office's response to section 21 – Error and fraud repellency and Horizon's 'fitness for purpose'

21.1 Section 21 of the Report considers whether Horizon is sufficiently error and fraud repellent. It raises 4 issues:

- a. Has Post Office sufficiently upgraded and developed Horizon over time?
- b. Does Horizon accurately record transactions processed in branches?
- c. Is Horizon resistant to power and telecommunications failures?
- d. Should Horizon work for every single user no matter their competence?

### Developing Horizon

21.2 The Report states that Post Office has not sufficiently upgraded and developed Horizon over the years so that there is a situation where "*errors and fraud that could, in our view, have been designed out of the system*" did not happen. As a result, the Report alleges that Subpostmasters have been liable for losses that could have been avoided.

21.3 This conclusion is unsupported by any evidence and is incorrect.

21.4 The Report contains no analysis of the development of Horizon over the years. It is unclear on what basis the Report considers Horizon to be under-developed when there has been no consideration of Post Office's processes for reviewing and improving Horizon or of the upgrades that have been implemented.

21.5 Post Office in fact has a number of processes in place for regularly reviewing and improving Horizon. These include:

- a. **Incident and Problem Management processes.** Both of these processes ensure that where a branch reports an issue it is investigated and resolved. Where several instances of the same issue occur, then a problem record is created and the root cause of the issue is identified and fixed (i.e. to avoid further instances). The

Confidential

resolution of problems can sometimes be minor amendments to processes or can result in a change to the software code via the next release of upgraded software.

- b. **Operational reviews with Fujitsu.** These take place on a monthly basis across a number of different specialist teams in both Post Office and Fujitsu. The purpose is to monitor and review past performance, addressing any issues as required and to prepare for known changes or upcoming events.
- c. **Operational reviews with the NFSP.** These have been in place for over 10 years and have operated on either a monthly or quarterly basis across that period. It has involved the NFSP Executives meeting with senior representatives from Post Office's IT Service, Network and FSC teams. A number of operational issues are raised via these meetings and actions are taken to resolve and improve either Horizon or associated processes. Other systems are also discussed as and when relevant, e.g. ATMs.
- d. **Continuous Service Improvement.** This is a standard process that Post Office's IT Services operates with all of its suppliers. Post Office considers that Fujitsu are particularly good in this area and have, over a number of years, developed and introduced a number of improvements. This has included Fujitsu, by their own initiative, providing additional funds to be used by Post Office for improvements to Horizon. Fujitsu were not contractually obliged to do this. The approach agreed with Fujitsu was to use NFSP's input to drive the improvement initiatives. This process and the tri-party working, including NFSP members' active involvement in conducting demonstrations and tests, resulted in improvements directly driven by the NFSP and funded by Fujitsu.

- 21.6 Ultimately, the Report appears to agree with Post Office's position in that it states at paragraph 22.22 that "*a number of enhancements have been made to Horizon following experience and feedback*". Whilst specific examples are not provided in the Report as evidence, this shows that Post Office is engaged in evolving its systems to improve user experience.

Confidential

### Accuracy of capturing transactions

- 21.7 At paragraph 21.23 the Report states that, in Second Sight's opinion, for Horizon to be "*fit for purpose*" for all users it needs to record and process the wide range of products and services offered by Post Office and enable Subpostmasters to investigate any cause of issues that may arise. The Report concludes that from the cases reviewed, although no specific examples are provided, that although the core software of the system works, it may not provide an ideal user experience for less IT literate users.
- 21.8 Horizon is capable of capturing all information and processing all transactions if used properly. No system errors have been highlighted in the Report. Further, no examples or explanations are provided to suggest that Horizon, if operated in accordance with standard operating procedure, would not accurately capture transaction data.
- 21.9 In fact, of the cases that have been fully reviewed so far, not one has presented any evidence whatsoever that Horizon did not accurately record the transactions processed by Applicants or their staff.
- 21.10 Horizon is designed to ensure the accuracy of transaction data submitted from branches. Safeguards are in place to ensure that no transactions are lost, altered or improperly added to a branch's accounts:
- a. **Encryption.** Transmission of transaction data between Horizon terminals and the Post Office data centre is encrypted.
  - b. **Net to Nil.** Baskets must net to nil before transmission. This means that the total value of the basket is nil and therefore the correct amount of payments, goods and services has been transacted – as the value of goods and service should always balance with the payment (whether to or from the customer). Baskets that do not net to nil will be rejected by the Horizon terminal before transmission to the Post Office data centre.
  - c. **No partial baskets.** Baskets of transactions are either recorded in full or discarded in full – no partial baskets can be recorded.
  - d. **No missing baskets.** All baskets are given sequential numbers (called 'Journal Sequence Numbers' or JSNs) when sent from a Horizon terminal. This allows

Confidential

Horizon to run a check for missing baskets by looking for missing JSNs (which triggers a recovery process) or additional baskets that would cause duplicate numbers (which would trigger an exception error report to Post Office / Fujitsu).

- e. **Secure data store.** Transaction data is stored on a secure audit server. All transaction data is digitally sealed – these seals would show evidence of tampering if anyone, either inadvertently, intentionally or maliciously, tried to change the data within a sealed record.

21.11 In summary, Post Office remains confident that Horizon accurately records transaction data and the Report presents no evidence to change this conclusion.

#### **Power and telecommunications failures**

21.12 Despite the assertions made in this section of the Report, Post Office maintains that Horizon is capable of handling power and telecommunications problems. There is no evidence to suggest that either of these events would cause losses in branches where the recovery process has been correctly followed by branch staff. There is also no evidence that the recovery system may, as suggested in paragraph 21.8, *“not always have performed as it was meant to after a reboot”* or to support the conclusion made in paragraph 21.15. There is, however, evidence of branch staff failing to follow the recovery process properly. This would cause discrepancies in a branch’s accounts and could be a cause of losses. It is, however, the result of human error by Applicants or their staff.

21.13 In Post Office branches, Subpostmasters are responsible for power supplies and the cabled telecommunications line (see paragraph 5.6 in the Part One Briefing Report). Interruptions in power supplies and telecommunication lines are a risk faced by all IT systems. There are, however, recovery systems built into Horizon to prevent losses occurring where there is a power or telecommunication failure. The following is a description of the recovery process:

- a. Following a failure to contact the Data Centre and complete a transaction, the system would automatically carry out a retry and attempt to save the basket to the Data Centre again.

Confidential

- b. Following the failure of the second attempt, a message displays to the User informing them that there was a failure to contact the Data Centre and asking them if they wish to Retry or Cancel. It is recommended that Users only 'Retry' a maximum of twice.
- c. When the User selects 'Cancel' this results in a Forced Log Out. This means:
  - i. Horizon would cancel those transactions that could be cancelled.
  - ii. Horizon would then print out 3 copies of a Disconnected Session Receipt (one for the customer, one for branch records and one to attach to the till to aid with recovery).
  - iii. The receipt would show transactions that are either recovered or cancelled. Those products considered recoverable must be settled with the customer in accordance with the Disconnection Receipt.
  - iv. If a transaction is cancellable then stock should be retained by the branch.
  - v. Horizon would then log out the active user.
- d. The Subpostmaster should then make sure that, in accordance with the Disconnect Receipt, the Customer is provided with any funds due to be returned to them in accordance with the Disconnect Receipt.
- e. The system would then display the Log On screen. The User may then attempt to Log On again.
- f. As part of the Log On process, the system checks the identity of the last Basket successfully saved at the Data Centre and compares it with the identity of the last Basket successfully processed by the counter. If the last basket saved in the Data Centre has a higher number than that considered to be the last successful basket processed by the counter, the recovery process at the counter would then repeat the process that the counter had carried out at the point of failure.
- g. A Recovery receipt would have been printed reflecting these transactions.
- h. A message is displayed to the user confirming that the recovery is complete. They then return to the Home screen. Depending on the transactions being conducted at

Confidential

the time, the user may be asked a series of questions to complete the recovery process.

- 21.14 At paragraph 21.5 onwards, Second Sight has raised a single challenge to the recovery process. It says that it believes that sometimes key messages are not displayed on the Horizon screen during the recovery process. Unfortunately, Second Sight has presented no evidence to support this allegation. This situation has also not been raised in any case seen by Post Office. Until such time as Second Sight is able to substantiate this speculation, Post Office maintains that the recovery process is robust.
- 21.15 Paragraph 21.8 states that Second Sight's Interim Report also reached this same conclusion in respect of the recovery process. This is incorrect as the Interim Report, when considering the recovery process, stated (at paragraph 1.13 of Appendix 1) that "*the Horizon system did operate in accordance with its design*". It is noted that Second Sight did question the speed of the recovery process in its Interim Report but it is only in its latest Report that it now questions the reliability of the recovery process. As mentioned above, Second Sight has not presented any evidence to substantiate its views, making it impossible for Post Office to understand how or why Second Sight has changed its position.

### **Fitness for all users**

- 21.16 At paragraph 21.25, the Report notes that there are some people who are unsuited from the outset to using a computerised branch. How this relates to the question of whether Horizon is fit for purpose is unclear.
- 21.17 Horizon is operated by thousands of Subpostmasters, the majority of whom have not had any issue with the system or its effectiveness. Whilst a small number may find the operation of the system difficult, this does not mean that the Horizon system is at fault. The subjective experience of a few people is not evidence that an IT system is objectively not fit for purpose.
- 21.18 For such an assessment to be carried out, the Report would need to identify some form of industry benchmark against which to judge Horizon. Also, the phrase 'fitness for purpose' has a specific legal meaning and is therefore a subject on which Second Sight has no expertise to offer an opinion. The Report does not establish or seek to articulate any legal or industry benchmark and so its findings are unsupported by evidence or any robust analysis.

Confidential

21.19 Post Office maintains that the fact that almost 500,000 users have used Horizon since its inception and only 150 have raised a complaint to the Scheme shows that it is fit for purpose.

21.20 Post Office rejects the assertion made at 21.31 that it does not improve its processes. The Branch Support Programme was established to consider what more could be provided to improve the effectiveness of the support that Post Office provides to Subpostmasters and operators in the running of their Post Office branches from an operational and engagement perspective. This work is continuing and involves:

- reviewing the life cycle of the Subpostmaster and all touch points with the business;
- taking input from owners, users and recipients of Post Office policies and processes;
- designing policies and processes that deliver improved ways of working with the Subpostmaster network in a cost effective and engaging way; and
- implementing improvements as soon as possible.

21.21 The focus of the programme is predominately how the business supports the agency network and the policies and processes that impact on the Subpostmaster. However, where the issues are the same for the Crown network then these are also included within the scope of this programme.

21.22 Post Office therefore does look to improve its processes as any prudent business does.



Confidential

**Post Office's response to section 22 – One-sided transactions**

- 22.1 Section 22 of the Report comments on what it calls 'one-sided transactions'. These are transactions that the Report states have not fully completed all the constituent parts of the transaction. This is either because: (i) there has been a charge to the customer for goods or services but they do not receive the goods/service; or alternatively (ii) a transaction is processed but the customer's bank account is not charged for the purchase.
- 22.2 The Report speculates that these situations could, somehow, give rise to a loss to a Subpostmaster. However, no evidence has been presented by Second Sight that there is a general issue with Horizon or Post Office's processes that could give rise to the above scenario.

**Safeguards**

- 22.3 The Report suggests at paragraph 22.2 that one cause for a 'one sided transaction' is owing to a telecommunications failure. Post Office accepts that telecommunications issues can give rise to 'one-sided transactions'. This is an inevitable risk of transacting business across the internet and affects all retailers and banks. Also, like all retailers and banks, Horizon has recovery processes in place to rectify any 'one sided transaction' errors. These safeguards are specific to particular products so it is not possible to explain them all in one document.
- 22.4 Communication failures can have two broad impacts. The main impact would be the type of interruption that is addressed by recovery prompts that are referred to in section 21 of this Reply.
- 22.5 The other impact (which would affect the customer, not the Subpostmaster) would be where a debit card payment was interrupted after the bank had ring-fenced the customer funds for the payment but before the counter confirmed that the transaction was complete. This can lead to a situation where although there is no issue for the branch accounts, the customer is no longer able to draw down on funds in their bank account because they remain ring-fenced for the original attempted transaction. Banks have routine processes to clear down ring-fences within a couple of days or on an accelerated basis by specific enquiry. This would not affect branch accounts but could, of course, lead to customer complaints to their banks.



Confidential

### **No risk to branches**

- 22.6 From a branch's perspective no discrepancy will arise from a 'one-sided transaction' as the branch accounts are based on the information received by Horizon and not on the information held by a third party client.
- 22.7 If a transaction is recorded as completed on Horizon, then the accounts will also have recorded a corresponding payment from the customer or the handing over of cash or stock to the customer.
- 22.8 If Horizon records the transaction as failed, then the transaction will not complete on Horizon and no payment, to or from the customer, will be recorded. Likewise, as Horizon records the transaction as failed, the branch staff should not hand over any cash or stock to a customer.
- 22.9 Regardless of whether the client's IT systems record a completed transaction or not, the effect of the above is that the branch accounts will be in balance. The fact that there may be a discrepancy between Horizon and the third party client's records does not, as described above, change the branch's accounting position.
- 22.10 For this reason, the statement at paragraph 22.11 about Post Office's Suspense Account is inaccurate. The safeguards described above ensure that any sums held in the Post Office central Suspense Account are investigated as fully as possible. In any event, the releases to profit should be considered within the overall context of Post Office performing around 2.5 bn transactions per annum, with a combined value in the order of £60bn. The amount of unresolved credits that end up in Post Office's P&L is therefore less than 0.001% of all transactions (by value) undertaken by branches.

### **Branch awareness of this issue**

- 22.11 At paragraphs 22.3-22.7 the Report states that the only way a 'one-sided transaction' would be discovered is if the customer was to notify the branch. The Report goes on to suggest that where the customer has benefited from the transaction (i.e. they have received goods which they did not pay for) they would not be aware or would not say anything. Therefore, the Subpostmaster would only be aware of the error if the customer disclosed it.
- 22.12 For the reasons stated above, this view is incorrect and, in any event, irrelevant as a branch will never be liable for an error caused by a 'one sided transaction'.

Confidential

## **Conclusion**

22.13 In summary, whilst the Report fails to prove that this is an issue of general application, Post Office has demonstrated that a 'one-sided transaction' cannot give rise to a loss to Subpostmasters.

Confidential

**Post Office's response to section 23 – Hardware issues**

- 23.1 Section 23 of the Report makes some general comments and observations about Horizon terminals and other associated branch hardware.
- 23.2 Post Office accepts that hardware problems can arise and that equipment is replaced from time to time. However, this is very dependent on the circumstances of an individual case and does not give rise to a general issue.
- 23.3 Further, the Report does not attempt to undertake any form of statistical analysis or industry benchmarking. In this area, it would be common to see an assessment of 'mean time between failures' as a way of judging performance.
- 23.4 In any event, as described in section 21 of this Reply, there is a recovery process in place to manage hardware failures.
- 23.5 Paragraph 23.1 of the Report highlights that some Horizon equipment is more than 10 years old. Whilst this may be correct, there is nothing to show that the age of the equipment is a cause of any losses.
- 23.6 At paragraph 23.2 the Report states that there is little routine hardware maintenance. This is correct but equipment is replaced as and when needed and this is industry standard practice.
- 23.7 Paragraph 23.4 states that many Applicants believe that faulty equipment could be responsible for the losses suffered. However, the Report acknowledges that Second Sight *"have been unable to come to a reliable, evidenced based view on this matter"*, and no evidence has been put forward to support the allegation that hardware issues have caused losses in branches.

Confidential

**Post Office's response to section 24 – Post Office Audit Procedures**

- 24.1 Section 24 of the Report comments on Post Office's procedures for auditing branches.
- 24.2 The Report says at paragraph 24.1 that Applicants have alleged that they were not provided with copies of audit reports, although it does acknowledge, at paragraph 24.2, that Post Office's current practice is to provide each Subpostmaster with a copy of any audit report. The practice of providing a copy of the audit report has always been in place.
- 24.3 Post Office is not aware of Applicants not being provided with copies of audit reports when requested. However, Post Office cannot categorically say that this has never happened in an individual case. Nevertheless, the lack of access to an audit report is not a cause of losses in a branch and would not exonerate a Subpostmaster from their contractual responsibility to make good losses caused in their branch that were revealed by an audit.
- 24.4 At paragraph 24.3 onwards, the Report repeats the concerns of Applicants about the scope and conduct of Post Office audits. However, it does not offer any opinion or analysis of those concerns. For its part, Post Office has found no evidence in any of the cases reviewed to substantiate allegations that its auditors acted improperly.

Confidential

**Post Office's response to section 25 – Post Office Investigations**

- 25.1 Section 25 of the Report provides Second Sight's opinion on the process that is undertaken by Post Office when it investigates branch activity, including potentially criminal conduct.
- 25.2 This topic is outside the scope of the Scheme (which is to consider "*Horizon and associated issues*") and is also outside the scope of Second Sight's expertise as forensic accountants. In addition, much of this section of the Report is based on generalised and anecdotal assertion which is unsubstantiated. Post Office therefore disputes the findings Second Sight makes in this section of the Report on both counts.
- 25.3 Nevertheless, Post Office needs to address some specific inaccuracies which Second Sight advance in this section of the Report concerning the criminal offence of false accounting. Post Office denies Second Sight's assertion that the focus of Post Office investigators is to secure an admission of false accounting and not to consider the root cause of any losses. This is incorrect – Post Office investigators' first task is to establish what has happened in the branch and its approach to each investigation will, by necessity, be influenced by the particular circumstances of the individual case.
- 25.4 That task will be frustrated when the branch accounts have been deliberately falsified, which is an act which precedes any Post Office investigation. By falsifying the accounts (whether through the inflation of cash on hand or otherwise) Subpostmasters or their assistants prevent Post Office from being able to identify the transactions that may have caused discrepancies and losses. The first step in identifying a genuine error is to determine the days on which the cash position in the accounts is different from the cash on hand. Where the cash on hand figure has been falsely stated, this is not possible.
- 25.5 The false accounting therefore hides any genuine errors from Post Office. It hides it at the time the losses occur and it remains the case now that Post Office is not able to identify which transactions may have caused the losses. The Report is therefore entirely incorrect in its evaluation of how Post Office approaches prosecutions. It is the Subpostmaster's (or their assistant's) false accounting that prevents Post Office from investigating the underlying losses, not the attitude of Post Office investigators.

Confidential

- 25.6 It is important to understand that Subpostmasters are not prosecuted by Post Office for incurring losses in branch. Post Office may, however, bring a prosecution where it suspects a criminal offence (such as deliberate false accounting) has been committed.
- 25.7 Where the Post Office discovers evidence of criminal wrongdoing, it may exercise the right to bring a private criminal prosecution which is available to all companies and individuals in England and Wales. In deciding whether a case is suitable for prosecution, Post Office considers (among other factors) whether it meets the tests set out in the Code for Crown Prosecutors. That Code requires Post Office to be satisfied that there is sufficient evidence for a realistic prospect of conviction and that the prosecution is in the public interest. The Code is issued by the Director of Public Prosecutions and followed by Crown Prosecutors. Like the CPS, Post Office keeps cases under continuous review all the way up to and during any trial, and when Post Office does decide to prosecute, its conduct of the prosecution is scrutinised by defence lawyers and ultimately by the Courts themselves.

Confidential

### Conclusion

- 26.1 Investigating each Reported Issue, and responding to the challenges put to Post Office by Second Sight has reinforced Post Office's confidence that there are no systemic flaws in Horizon. This was the position adopted by Second Sight in its Interim Report and it is the reason that Post Office was determined to address each Applicant's concerns on a one-to-one basis rather than through an open-ended, general investigation. This approach has now resolved a number of complaints.
- 26.2 Where the facts of a specific case indicate genuine grievances, for example that the support provided in a particular instance fell short of the desired standards, those issues are being discussed with Applicants and a number of complaints have been resolved.
- 26.3 However, many cases are based on allegations which, following investigation, are not supported by the evidence.
- 26.4 Post Office announced last month that it will now put forward for mediation all cases remaining in the Scheme except those that have been subject to a previous court ruling. This will accelerate the conclusion of the Scheme in the interests of Applicants and ensure that commitments made to Applicants at the outset are met. The mediation process will continue to be overseen by the Centre for Effective Dispute Resolution.
- 26.5 For those Applicants who have been the subject of court rulings, two important points need to be drawn out. Firstly, we will continue to consider each of these cases carefully, on a case by case basis, even though mediation cannot overturn a court's ruling.
- 26.6 Secondly, as a prosecutor, Post Office has a continuing duty after a prosecution has concluded to disclose immediately any information that subsequently comes to light which might undermine its prosecution case or support the case of the defendant.
- 26.7 The Post Office acknowledges this has been a long and difficult process but has gone to great lengths to address each and every complaint and remains determined to resolve them where possible.